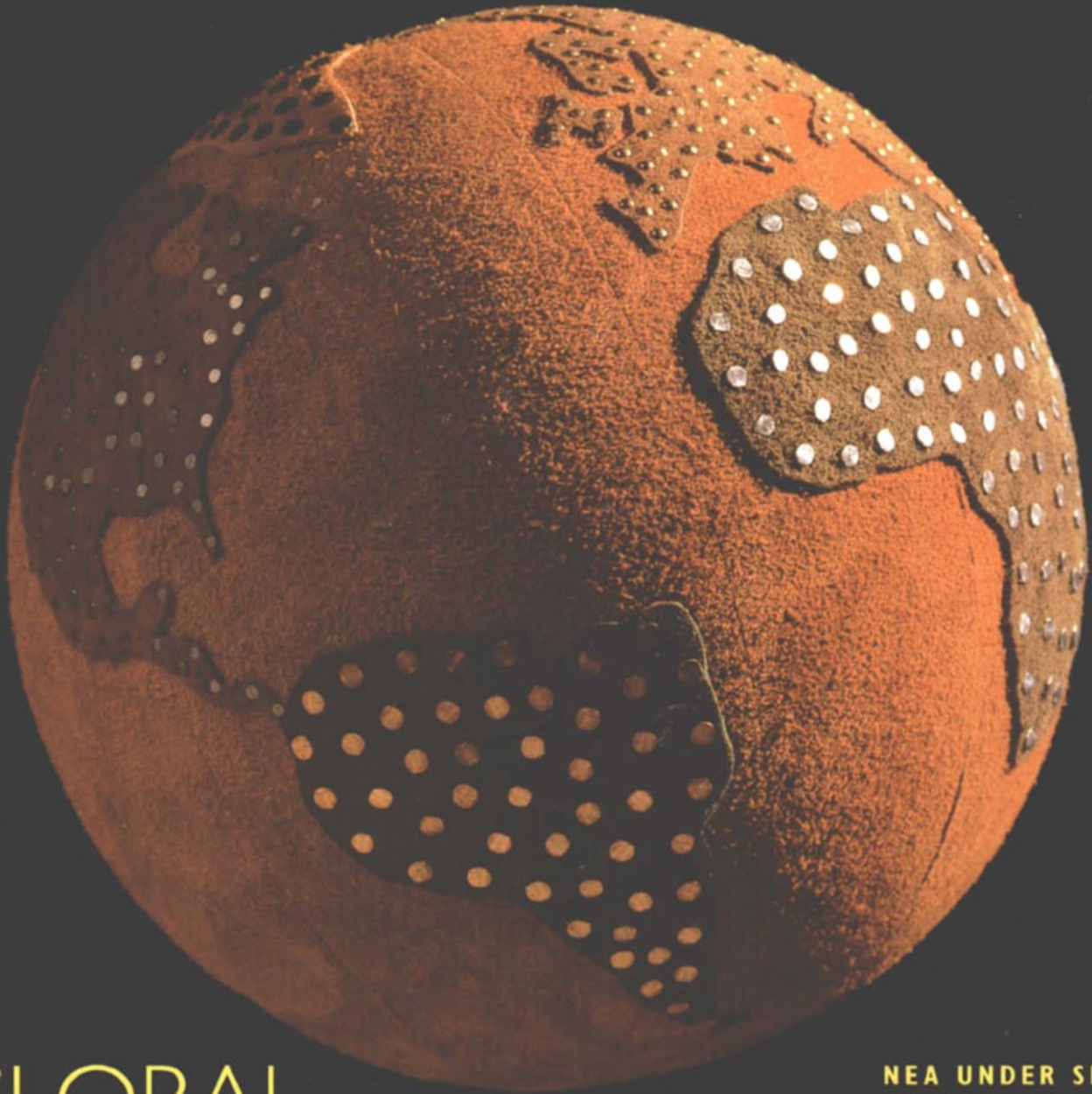


T H E Brookings R E V I E W

WINTER 1993 \$4.50



GLOBAL
DRUG
SCOURGE

NEA UNDER SIEGE
IF CHILDREN COULD VOTE
HOPE FOR RUSSIA?
NORTH AMERICAN TRADE
OUR TROUBLED FACTORIES

Germany Divided

From the Wall to Reunification
A. James McAdams

Germany Divided is the first scholarly and comprehensive interpretation of the forty-year relationship between East and West Germany.

A. James McAdams dissects the complex process by which East and West German leaders moved over the years from pursuing the ideal of German unity to meeting the challenges of an unanticipated reunification.

In addition to relevant primary and secondary materials from both German states,

McAdams draws on an unprecedented series of interviews conducted throughout the 1980s and early 1990s with government officials in both East and West Germany. With this unique access to information on high-level decision making, he chronicles an era when the restoration of German unity appeared anything but assured.

Princeton Studies in International History and Politics
Editors: John Lewis Gaddis, Jack L. Snyder, and Richard H. Ullman
Cloth: \$29.95 ISBN 0-691-07892-0

Due January 1993



The Gulf Conflict: 1990-1991

Diplomacy and War in the New World Order
Lawrence Freedman and Efraim Karsh

The Gulf Conflict provides the most authoritative and comprehensive account to date of the "Gulf War" and its aftermath. In a compelling narrative history, Lawrence Freedman and Efraim Karsh, experts in international affairs and the Middle East, explore the fundamental issues underlying the dispute. They analyze the war in relation to more general problems of the conduct of

diplomacy and the role of military force in the "New World Order."

The authors have uncovered new material not used in previous accounts, gathered from government and other official documents, newspaper files, academic studies, and personal interviews with policymakers from both sides. This promises to be the standard work on the Gulf conflict.

Available from Princeton in the United States and Canada only

Cloth: \$24.95 ISBN 0-691-08627-3

Due January 1993

Princeton University Press

41 WILLIAM ST., PRINCETON, NJ 08540 • ORDERS: 800-777-4726 • OR FROM YOUR LOCAL BOOKSTORE

DIRECT ACCESS ▼

TO SENIOR GOVERNMENT OFFICIALS. ANYWHERE IN THE WORLD.

HERE IS AN INDESPENSIBLE TOOL FOR ANYONE IN ECONOMICS, FOREIGN POLICY, RESEARCH, GOVERNMENT OR EDUCATION WHO REQUIRES QUICK AND EASY ACCESS TO HIGH-LEVEL GOVERNMENT OFFICIALS *ANYWHERE IN THE WORLD*.

The **Worldwide Government Directory** is a single volume 1,200 page reference guide to *key* elected and appointed government officials in 192 nations *including all former Soviet Republics*.

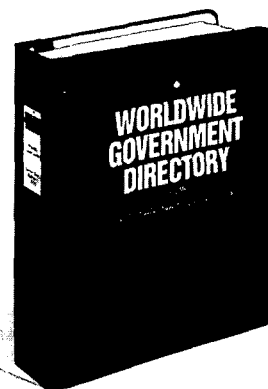
Now in its ninth edition, **WGD** allows you direct communication with more than **50,000** ministers, undersecretaries, directors, deputies, advisors, aides and other primary figures in executive, legislative, judicial branches as well as the defense and diplomatic communities.

Names, official titles, office addresses, telephone, facsimile and cable numbers are all provided, often with as many as 19 pages of information per country. **WGD** gives you organizational structures, political parties, dates of upcoming elections, 106 international organizations and much more. **Every entry is verified.**

The Worldwide Government Directory Is Now Available With Monthly Updates.

The **Worldwide Government Directory Monthly Update Service** is designed for individuals and organizations *who must maintain the most current information* on senior officials in every national government. You receive all the same listings as the **WGD** hardcover edition. Then, as the latest personnel changes from around the world are collected by our research staff and their accuracy confirmed—a task taking hundreds of man hours each month—the updated information is forwarded to you.

For More Information On All Our Products And Services, Call 1-800-332-3535, or (202) 232-6334.



The New WGD Monthly Update Service
NOW AVAILABLE

LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED
BELMONT PUBLICATIONS
1454 Belmont Street, N.W., Washington, DC 20009 (202) 232-6334 FAX: (202) 462-5478

THE Brookings REVIEW

WINTER 1993 VOL. 11 NO. 1

6 WORLDWIDE DRUG SCOURGE

The expanding trade in illicit drugs

Stephen Flynn

12 ON THE ROAD TO PARADISE AGAIN?

Keeping hopes for Russia realistic

Jerry Hough

18 AN IMMODEST PROPOSAL

Let's give children the vote

Paul E. Peterson

24 WHO ARE THE NATION'S "TRULY POOR"?

Problems and pitfalls in (re)defining and measuring poverty

Robert Haveman

28 STUDENT AID

Price discount or educational investment?

William G. Bowen and David W. Breneman

32 ARTIFACTIONS

The battle over the National Endowment for the Arts

Michael C. Dorf

36 MADE IN THE U.S.A.

Productivity and competitiveness in American manufacturing

Martin N. Baily

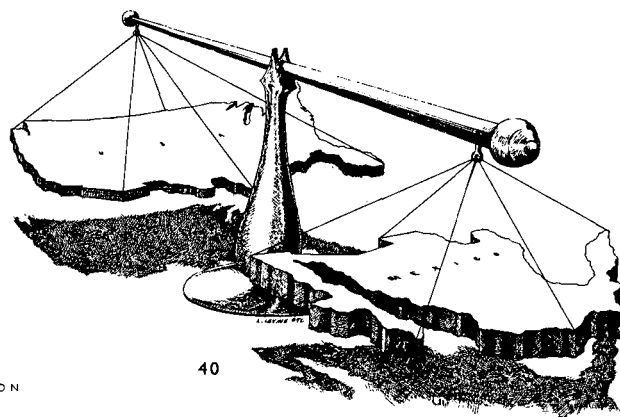
40 NAFTA AS THE CENTER OF AN INTEGRATION PROCESS

The nontrade issues

Robert A. Pastor



32



COVER ILLUSTRATION
BY JERRY PAVEY

40

Letters 3

A Considered Opinion

From campaigning to governing

Thomas E. Mann 4

World Watch

Tough and smart on China

Harry Harding 46

Economy Watch

Free trade with Mexico?

George L. Perry 47

The Brookings Institution is an independent, nonprofit organization devoted to nonpartisan research, education, and publication in economics, government, foreign policy, and the social sciences generally. Its principal purposes are to aid in the development of sound public policies and to promote public understanding of issues of national importance. The Institution was founded on December 8, 1927, to merge the activities of the Institute for Government Research, founded in 1916, the Institute of Economics, founded in 1922, and the Robert Brookings Graduate School of Economics, founded in 1924. The Institution maintains a position of neutrality on issues of public policy to safeguard the intellectual freedom of the staff. Interpretations or conclusions in Brookings publications should be understood to be solely those of the authors.

Board of Trustees

John C. Whitehead
Chairman

Ronald J. Arnault
Elizabeth E. Bailey
Rex J. Bates
Louis W. Cabot
A. W. Clausen
John L. Clendenin
Kenneth W. Dam
D. Ronald Daniel
Walter Y. Elisha
Stephen Friedman
William H. Gray III
Teresa Heinz
F. Warren Hellman
Samuel Hellman
James A. Johnson
Thomas W. Jones
Vernon E. Jordan, Jr.

Nannerl O. Keohane
Martin J. Koldyke
Thomas G. Labrecque
Bruce K. MacLaury
Donald F. McHenry
Constance Berry Newman
Maconda Brown O'Connor
Samuel Pizar
James D. Robinson III
David Rockefeller, Jr.
Howard D. Samuel
B. Francis Saul II
Ralph S. Saul
Donna E. Shalala
Robert H. Smith
John D. Zeglis
Ezra K. Zilkha

Honorary Trustees

Vincent M. Barnett, Jr.
Barton M. Biggs
Edward W. Carter
Frank T. Cary
William T. Coleman, Jr.
Lloyd N. Cutler
Bruce B. Dayton
Douglas Dillon
Charles W. Duncan, Jr.
Robert F. Erburu
Robert D. Haas
Pamela Harriman
Huntington Harris
Andrew Heiskell
Roger W. Heyns

James A. Joseph
John E. Lockwood
James T. Lynn
William McC. Martin, Jr.
Robert S. McNamara
Mary Patterson McPherson
Arjay Miller
Donald S. Perkins
J. Woodward Redmond
Charles W. Robinson
Robert V. Roosa
Henry B. Schacht
Gerard C. Smith
Robert Brookings Smith
Morris Tanenbaum
Phyllis A. Wallace
James D. Wolfensohn

President

Bruce K. MacLaury

Vice President External Affairs

John M. Hills

Director of Publications

Robert L. Faherty

The Brookings Review

Editor

Brenda Szittya

Production

Susan F. Woollen

Proofreader

Ellen Garshick

Marketing and Advertising

Jill Bernstein
Gail Sipfle
Elizabeth A. Benevides
Glenda Simmons

Circulation

Renuka Deonarain
Ann M. Lofton

Subscription rates:

one year \$17.95 (\$24.95
foreign); two years \$32.95
(\$46.95 foreign).

Postmaster, send address changes to:

The Brookings Review,
1775 Massachusetts Ave.,
N.W., Washington, D.C.
20036

Subscription queries:

(800) 257-1447
(202) 797-6255

Advertising sales:

(202) 797-6254

U.S. newsstand distribution by:

Ingram Periodicals Inc.
1117 Heil Quaker Blvd.
La Vergne, Tenn. 37086
(800) 627-6274 (ext. 4500)

The Brookings Review

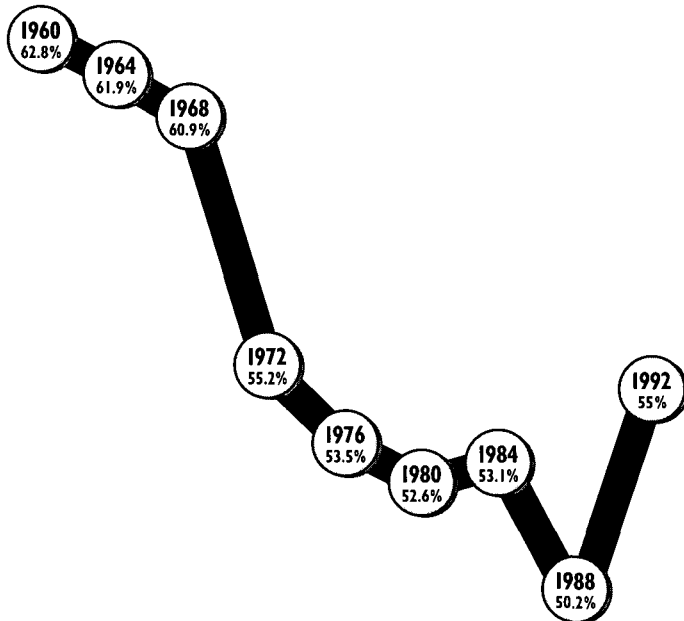
(ISSN 0745-1253)
is published quarterly by
The Brookings Institution.

Copyright © 1993 by
the Brookings Institution.
All rights reserved.

Application to mail at
second class is pending at
Washington, D.C.
USPS I.D. No. 14209;
Publication No. 551640.

Design and art direction by
Meadows & Wiser

Of the Rich, by the Rich, for the Rich?



■ Ruy A. Teixeira (“Voter Turnout in America,” fall issue) does a mostly masterful job explaining how myths about low voter turnout in the United States stand in the way of actions that could increase the number of Americans who exercise their franchise. His attempt, however, to dispel the myth that turnout went down between 1960 and 1988 because poor people were voting less is not wholly convincing. After all, as Teixeira himself explains, the rate of voter turnout was declining faster among poor people than among affluent ones. Given that almost any baseline comparison of the voting rates of the poor versus the affluent would demonstrate that the poor were always substantially less likely to vote, their faster rate of “dropping out of politics” means that electoral decisions were more and more precipitously turned over to the most affluent. This is especially troubling because other forms of participation—campaign contributions, lobbying, and even protest politics—have become more, rather than less, skewed to the affluent (as new data provided in a mas-

sive survey being analyzed by Sidney Verba, Kay Schlossman, Norman Nie, and others indicate). Is American “democracy” becoming more than ever a government of the rich, by the rich, for the rich?

*Linda Faye Williams,
University of Maryland*

Nonvoting and Crime Rates

■ Ruy Teixeira (“Voter Turnout in America,” fall issue) makes the point that voter turnout has little effect on elections “as a rule,” that is, in most contests where the results are not close. But no single variable ever determines the outcome in such cases. Race, economic position, age, religious or ethnic background, PAC activity, campaign strategy, or voter turnout are determinative only when the differences between winner and loser are narrow. Teixeira documents this when he reports that in 1988, if “black turnout and white (non-Hispanic) turnout had been the same (black turnout was about 10 percentage points lower), Dukakis would have gained about 1,442,000 votes”—that is,

more than enough to affect a close election, such as that in 1968, though not the 1988 one.

To evaluate how much turnout would improve if election rules were to be changed as Teixeira suggests requires examining variations among the states and over time. North Dakota and Minnesota, for example, have made it easier to vote, and turnout is indeed somewhat higher there than in other states, but it has declined there too. And the Scammon Commission, appointed by President Kennedy, suggested reforms to make it easier to vote. Most were adopted, but the proportion who vote went down thereafter.

Americans are much less likely to vote than residents of other major industrial nations—25 percent less than Canadians. Why? Americans generally are more disposed to be disobedient, to violate the law more than other peoples. (They are also more likely than Canadians to cross against red lights.) The major argument for voting, since almost everyone knows no single vote will affect the outcome, is that it is what a good democratic citizen should do. But Americans do not accept such arguments, do not conform. The increase in nonvoting in the United States between 1960 and 1988 parallels the growth in other indicators of deviance. How does variation in nonvoting correlate with crime rates in the United States? It would be interesting to find out.

*Seymour Martin Lipset,
George Mason University*

Fight Crime, but Don't Forget the States

■ John J. Dilulio's proposal (“A Limited War on Crime That We Can Win,” fall issue) that the federal government prescribe and assume full nationwide funding of two

promising crime responses—inner-city community policing and correctional institution drug treatment—is tempting, but it raises a number of concerns.

First, a strength of the U.S. justice system is its decentralization and respect for principles of federalism. The successful strategies recommended by Dilulio originated at the state and local levels. A major commitment of federal dollars would not encourage local control and innovation.

Second, the effectiveness and efficiency of programs may be diminished by prescribing, packaging, and “nationalizing” them. The local drug treatment programs cited by Dilulio in the 1989 study varied significantly in content and cost. For example, the atypical educational approach was less costly yet had the lowest recidivism rates.

Dilulio has a keen understanding of our nation's needs, and his call for the immediate and widespread adoption of both types of programs is well reasoned. But the federal government alone should not assume this major commitment and traditionally shared responsibility. A better approach would be a comprehensive one—one that promotes innovation through research, statistics, demonstration, evaluation, training, and some financial assistance—with greater reliance on shared commitments with the states and localities.

*Steven D. Dillingham,
U.S. Department of Justice*

BIDs Are No Threat to Government

■ Janet Rothenberg Pack's use of the term “private governments” (“BIDs, DIDs, SIDs, SADs: Private Governments in Urban America,” fall issue) may be misleading.

Few business leaders who
Continued on page 48

From Campaigning to Governing

BY THOMAS E. MANN

The election of Bill Clinton as president and the return of unified party government has raised the hopes of many who were dispirited by years of political squabbling between the branches and by public outrage at those who run our government. One needn't be a partisan Democrat to experience a sense of relief that the old political regime of a Republican president doing battle with a Democratic Congress was denied another four-year lease by the electorate. But will the

bracing November winds of change be sufficiently powerful to lift the pall over Washington and restore purpose and effective performance to government? Much depends on a successful transition from campaigning to governing.

No aspect of our politics has been more troubling in recent years than the gulf between the conduct of campaigns and the real problems confronting the victors when the shouting is over. The 1988 election is often seen as the prototype in this

regard. Whatever the underlying logic of that election—an incumbent party returned to office in generally good times—the campaign itself was negative and desultory, with little discussion of the problems confronting the country and no clear signal from the public. While George Bush comfortably won the presidency, his party lost further ground in Congress, leaving him in the weakest position of any newly elected president in our history. A distasteful process, no man-

date from the voters, no basis for governing.

George Bush suffered in the end from his failure to appreciate the importance for governing of what is said or left unsaid during the campaign. By all accounts Bush finds campaigning extremely distasteful: a nasty business one must go through to reach the prize of the Oval Office. Say whatever you need to say to voters during the campaign, but then do the responsible thing once in office.

This perspective robs elections of two of their essential elements beyond the choice of a person to serve as president. The first is the content of the campaign. Does it clarify key choices for the country, build public support for new policy decisions, facilitate an honest conversation between citizens and leaders? The second is the means of governing. Does the election create a political basis for action in government through a sense of shared fate between the president and Congress?

How did the 1992 election stack up on these terms? The campaign had its share of shortcomings. The candidates were often unwilling to grapple seriously with difficult problems, at least partly because they believe the public won't tolerate frank talk. Neither Bush nor Clinton, for example, advanced aggressive plans to deal with the budget deficit. Plans for economic recovery were carefully crafted to spread benefits widely and to target costs narrowly if at all. Even Ross Perot, who billed himself as the only candidate willing to level with the American people about the country's problems and the difficult choices ahead, looked every bit the conventional politician as he burnished his personal image and eschewed



straight policy talk in the final weeks of the campaign. The public seemed more enamored than ever with conspiracy theories that conveniently attribute policy failures to unnamed corrupt special interests and avoid any need for shared sacrifice.

And yet there were positive signs in this election year. Economic anxieties seemed to produce a new sobriety among voters, leading to a diminished tolerance for irresponsible negative campaigning and a demand for a positive program for governance. The candidates in turn produced detailed plans for the next four years and then used new media formats that gave them extended opportunities to discuss those plans. The public kept the campaign focused on the big picture, followed the debates, and voted at a higher rate than in recent elections.

Voters gave Bill Clinton a solid plurality victory in the three-way national vote that, thanks to the winner-take-all provisions in the states, produced a large electoral vote majority. They also returned sizable Democratic majorities in the House of Representatives and the Senate. The overall results lacked the force of 1964 and 1980, when presidential landslides were accompanied by major gains in Congress by the president's party. But neither did 1992 mirror the threadbare victories of 1960 and 1976, both of which featured relatively contentless campaigns, narrow presidential margins, and the absence of coattails. Democrats did lose 10 seats in the House this year, but the loss was much smaller than they had feared only a year earlier. And the Republicans lost their best opportunity in a decade to regain control of the Senate.

A basis exists in the campaign and election returns for President-elect Clinton to claim a mandate from the public and to move decisively to convert campaign rhetoric into a governing agenda. Mandates are not objective readings of public sentiment; they are subjective interpretations of the meaning of elections constructed by victorious candidates and sold to other politicians, the press, and the public. It is politics as art, not science.

Clinton's immediate challenge is to fashion a mandate that is faithful to the central tenets of his campaign, attentive to the real problems facing the country, persuasive to members of the political community, and translatable into concrete proposals for executive or legislative action. Some elements are nonnegotiable: a public and private investment-based approach to creating jobs and fostering economic growth, a new Democratic social policy based on individual responsibility as well as government opportunity, national health care reform that extends coverage and controls costs, political reforms responsive to concerns about special interest influence, and a foreign policy anchored in democratic internationalism.

But on these and other aspects of Clinton's governing agenda much was left unsaid during the campaign. Now he must factor in a realistic appraisal of immediate and long-term needs of the economy. He may, for example, conclude that his microeconomic, deficit-neutral approach to stimulating the economy in the short term is insufficient to spur a more rapid recovery. Upon reflection, he may also judge that a supply-side approach to the deficit, in which



economic growth assumes the lion's share of responsibility for narrowing the gap between revenues and expenditures, must be buttressed with additional steps on entitlements and taxes.

Aside from the essential tasks of organizing the presidency and staffing the new administration, the time between the election and the inauguration is most profitably spent developing a realistic program for governing and preparing the public for the tough choices ahead. Our democracy will be strengthened only when we break the present pattern of dishonest conversation between leaders and citizens. The new president appears to relish the political dimension of his job as much as the policy side. Let's hope he follows up his successful campaign by engaging the public and members of Congress in a forthright discussion about what is needed to ensure a brighter future. ■

Thomas E. Mann is director of the Brookings Governmental Studies program and holds the W. Averell Harriman Chair in American Governance. He is co-director, with Norman J. Ornstein, of the Renewing Congress Project, and the editor, with Gary R. Orren, of Media Polls in American Politics (Brookings, 1992).

WORLDWIDE DRUG THE EXPANDING TRADE

STEPHEN FLYNN

Lieutenant Stephen Flynn is a Coast Guard officer who is serving as a guest scholar in the Brookings Foreign Policy Studies program.

This article presents the findings of a year-long project that he directed while serving as an adjunct fellow at the Center for Strategic and International Studies and as a Council on Foreign Relations International Affairs fellow. The author gratefully acknowledges the assistance of Rens Lee, Lamond Tullis, Richard Clayton, Bob Nieves, Felix Jimenez, David Long, Bill Taylor, Georges Fauriol, and Greg Grant.

This article is the first of a two-part series examining the global drug challenge in the post-Cold War era. The first part outlines how the revolutionary changes in the international system are altering patterns of drug production, trafficking, and consumption. The second part will examine current U.S. drug control strategy and suggest how it might be revised to secure better results both at home and abroad.

Now that the Cold War is over, calls for a greater emphasis on the American domestic agenda have reached a crescendo. The problem of illicit drugs is invariably mentioned as one of the leading domestic ills deserving the full measure of the federal government's attention. But the drug issue is no more purely a domestic problem than are ozone depletion and disease control. As with greenhouse gas emissions and the AIDS epidemic, the drug scourge is a global phenomenon, and it is expanding at an alarming pace. Further, even the most aggressive domestic response cannot insulate the United States from the political, economic, and social fallout associated with the explosive growth in illicit drugs worldwide.

In the Central Asian republics, for instance, thousands of acres have been given over to the cultivation of opium poppies and cannabis. Over the past year, Hungary and Czechoslovakia have become major transit countries for Asian heroin destined for West Europe. Recently, Polish health officials warned that a dramatic rise in intravenous drug abuse in Warsaw has unleashed an AIDS epidemic. Especially ominous are reports of expanding organized criminal networks engaged in drug trafficking with the former Soviet Union, Central Europe, and Latin America.

The surge in the illicit narcotics trade in Eurasia and elsewhere has been first and foremost fueled



JG SCOURGE IN ILLICIT DRUGS

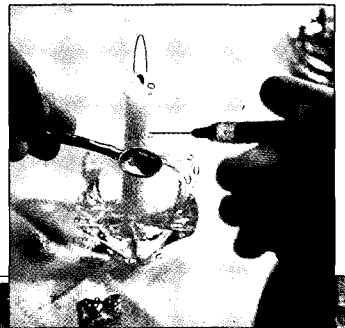


by its tremendous profitability. Today drugs are a \$100 billion a year transnational industry. The illicit stockholders and operatives come from every continent and include Colombians, Mexicans, Italians, Nigerians, Poles, Turks, Chinese, Lebanese, and Georgians.

Second, the recent unraveling of socialism and the move toward freer trade among industrialized countries has created a fertile environment for international businesses—even illicit ones—as deregulation and integration gather momentum. As commercial banks, investment firms, insurance companies, full-service brokers, and asset managers have all globalized their operations, the menu of financial institutions through which both clean and dirty money can be moved has never been so extensive. With the North American Free Trade Agreement, EC '92, the Asia-Pacific Economic Cooperation effort, and the collapse of the Iron Curtain, torrents of people, goods, and services are pouring across borders. In their midst, drug shipments can move with little risk of detection by customs authorities.

Third, the colossal social and economic dislocations connected with both the implosions of the communist world and the desperate standard of living in much of the third world are creating the ideal climate for widespread drug production and abuse. In the third world, the loss of superpower benefactors, declining rates of per capita GNP, unstable commodity prices, and rising domestic and foreign debt make the hard currency and profits connected with the drug trade almost irresistible. For many of the destitute and disaffected survivors of impoverished third world states and once rigidly controlled communist societies, drugs offer a seductive reprieve from an unpleasant world.

Finally, the recent resurgence of ethnic, religious, and nationalistic conflict slows or precludes altogether the development of new regional and international regulatory regimes to control illicit ac-



PHOTOS (CLOCKWISE FROM UPPER RIGHT): JON RILEY/FOLIO; PAUL THOMPSON/INT'L STOCK PHOTO; BARBARA VAN CLEVE/TSW; JIM PICKERELL/TSW



tivities within the global community. It also hampers intelligence sharing and cooperation among neighboring law enforcement agencies, a development of which criminal drug organizations are a direct beneficiary.

The results: the production of heroin, cocaine, cannabis, and synthetic drugs is at a record high and will continue to rise; narcotics traffickers are moving drugs and money throughout the international economy with virtual impunity; and drug consumption is exploding in many countries that had hitherto escaped the drug scourge.

Global Drug Production

Because drug production is illicit, estimating its worldwide extent can be no more than an exercise in guesswork. But clearly the production of opium poppy, coca, and cannabis is on the rise. According to U.S. government estimates, in 1991 cocaine production in Latin America grew by 85 tons—a 7 percent increase over 1990. Opium production was estimated to be 4,200 tons in 1991, a 33 percent increase since 1988. Hashish production from the four major producing countries grew 65 percent between 1990 and 1991 to 1,244 tons.

More disturbing than the rise in global drug production is the sudden proliferation of producers. Within Peru, the world's leading producer of coca, illicit cultivation has spread out of the Upper Huallaga Valley into the Cuzco, Ayacucho, Pasco, and Puno Departments. New coca cultivation has been reported in remote regions in Brazil, Ecuador, and Venezuela. Cocaine refinement, once restricted to Colombia, now takes place in Peru, Bolivia, Venezuela, Argentina, Ecuador, and Brazil. Brazil's involvement is particularly ominous since it is the only South American country where acetone and ether, the chemicals used to turn coca base into cocaine, are manufactured in industrial quantities. Over the past year, European authorities have even discovered cocaine processing laboratories in Portugal, Spain, and Italy.

Opium cultivation has spilled over from the traditional production regions of Mexico, the Golden Triangle (Burma, Thailand, and Laos), and the Golden Crescent (Pakistan, Afghanistan, and Iran). Guatemala and Colombia are now major source countries in the Western hemisphere. U.S. officials estimate that Colombia may have produced about 4 tons of heroin in 1992—close to Mexico's 6.8 tons in 1990. The Colombians almost certainly have the means to become the chief world heroin suppliers of the 21st century.

In Eurasia, extensive opium poppy cultivation has been reported in Poland, Ukraine, Moldova, the Caucasus, and Central Asia. In January 1992 Sergey Tershchenko, the prime minister of Kazakhstan, legalized the cultivation of the opium poppy. The government of Kyrgyzstan toyed with the idea, but backed away. In Central Asia, per capita income is approximately 40 percent below, and unemployment nearly 70 percent above, the average of the other former Soviet states. The economic incentives for poppy production will be even greater when Moscow ends its annual subsidy of billions of rubles to the region. Central Asia could very well become the "Andean region" of Eurasia.

Opium cultivation has also reemerged in China after being virtually eliminated by the communists when they seized power in 1949. Law enforcement authorities have spotted poppies in at least 13 of China's 23 provinces and 5 autonomous regions, with the largest plots in the remote

southern province of Yunnan and in the northern province of Inner Mongolia.

Among traditional source countries for cannabis (the United States ranks second), production fell in 1991 because of bad weather and stepped-up eradication efforts. Still, the capacity for large-scale cultivation is spreading quickly. Brazil has become a major producer, with illegal cultivation taking place in at least 20 of its 26 states. In the former Soviet Union cannabis plants grow freely on more than 2.5 million acres, mostly in Kazakhstan, Kyrgyzstan, Siberia, and the Far East. Cannabis is being grown throughout Africa. Hashish production soared in 1991, with Lebanon increasing its total production almost sixfold over 1990.

Production of synthetic narcotics also appears to be spreading. Laboratories in Taiwan and South Korea are the chief source of "ice," a high-purity methamphetamine developed during the mid-1980s. Poland has recently become one of the largest producers of amphetamines for the European market. According to police lab analyses, in 1991 some 20 percent of the amphetamines seized in West Europe and 25 percent of those seized in Germany originated in Poland. Underground laboratories for synthetic drugs have been discovered in Moscow, St. Petersburg, Sverdlovsk, and many other large cities in the former Soviet Union. Methaqualone ("mandrax") is produced throughout India, primarily for the large market in Southern Africa.

Spreading Like Weeds

Neither geography nor laboratory technology can constrain the cultivation of illicit drugs. Poppy, coca, and cannabis can be grown almost anywhere, and the ability to refine them or to produce synthetic drugs is widely available. All the coca and opium poppy plants being grown in the world would fill a space not much larger than the Eastern Shore of Maryland. The global capacity for cultivating these drugs is virtually untapped.

Illicit drug production is taking root most quickly in areas with few other meaningful economic options. Sub-Saharan Africa, Inner Mongolia, southern China, Central Asia, Afghanistan, and northeastern Brazil are among the most remote and impoverished places on the planet. Although peasants rarely get rich growing coca, poppies, or cannabis, they can earn up to 10 times what they can by growing traditional farm products. That can mean the difference between providing for the most basic needs of one's family or exposing it to life-threatening poverty.

Throughout much of the developing world, national currencies are nonexchangeable and worthless. Businessmen trying to finance capital improvements, insurgents and terrorists seeking the weapons and resources to fight their causes, and governments struggling to keep their economies afloat are in desperate need of hard currency at a time of global capital shortage. For them, too, the drug trade is almost the only answer.

The temptation to produce drugs may also prove almost irresistible in Eastern Europe and the former Soviet Union. One-third of the people in Hungary now live below the poverty level. By the end of 1991 unemployment in eastern Germany was 30 percent. In Russia as many as 10–11 million people, or 15 percent of the work force, may be unemployed by the year's end.

Drugs are usually produced where they are most difficult to stop—generally in remote areas safely outside a govern-



In Eurasia, extensive opium poppy cultivation has been reported in Poland, Ukraine, Moldova, the Caucasus, and Central Asia.

ment's reach, often in territory under the sway of insurgency groups. The criminal organizations that support drug production have the resources to corrupt, intimidate, or bypass the authority of governments that, in addition, often face political problems that are more pressing than drugs or cannot take effective enforcement action because of a lack of political legitimacy.

The "Big Business" of Drug Trafficking

In essence, drug trafficking is a form of commodities trade conducted by transnational consortiums. Acquiring chemicals to produce drugs, transporting the drugs to wholesale distributors, and laundering the profits require interacting with and blending into legitimate markets. The size and complexity of these operations mandate that the drug industry pattern itself after the modern multinational corporation. Yet unlike traders in oil, automobiles, or microchips, traders in illicit drugs must outwit a dynamic enforcement environment designed to defeat them. Consequently, over the past two decades the drug trade has undergone something of a Darwinian evolution, the survivors of which have developed into sophisticated and highly flexible organizations. As one senior American drug enforcement official put it, "Lee Iacocca could learn a heck of a lot from these people!"

For those in the business of moving illicit drugs and money, the post-Cold War era has much to offer: a trend toward privatization and liberalization; an increase in the volume and diversity of world trade; the deregulation of national economies; the integration of global transportation, communications, and financial systems; and increasingly open and unmonitored borders between states. And since trafficking organizations are not bound by the legal constraints of domestic and international commerce regulation, they are particularly well placed to respond rapidly and with considerable ingenuity to these changes in the international economic system.

A prime example of the modern drug trafficking organization is the Cali "cartel." Like its better known counterpart from Medellin, the Cali cartel is a loose conglomeration of Colombian families based in a major Colombian city. But unlike the often violent Medellin cartel, which conjures up images of well-heeled thugs surrounded by private armies, the Cali cartel operates more like the senior management team at Exxon or Coca Cola. Its transportation, distribution, and money-laundering networks cover the globe. Outside the Western hemisphere, Cali operatives work in Japan, Hungary, Czechoslovakia, Poland, Germany, Italy, Spain, Portugal, the Netherlands, France, and Great Britain.

Because the huge U.S. and European markets are so far from coca production areas, transportation is critical to the

cocaine business. Contrary to popular belief, most drugs do not cross American borders on low-flying Cessnas or aboard fast-moving "cigarette" boats. Most reach their markets by way of commercial conveyances. Containerized shipments, bulk cargo, false documentation, and front companies conceal the movement of cocaine by water. By land, most cocaine crosses the U.S.-Mexican border in hidden compartments of tractor trailers and other vehicles or in commercial cargo itself. For these border crossings, the Cali cartel relies on Mexican smugglers.

The Cali organization uses international shipping centers in Central and South America, particularly in Brazil, Venezuela, Surinam, and Panama, to ship cocaine by sea to Europe and to the eastern United States. It conceals the drugs in a variety of imaginative ways, one of the most creative of which was to hide 15.7 tons of cocaine in 2,000 concrete cement posts (U.S. authorities seized that shipment in September 1991). Occasionally drugs are shipped to the United States circuitously, passing through Europe or Canada before arriving.

When commercial airliners are used for shipping cocaine, the drug is hidden on the plane itself, or it is carried by human "mules," who swallow condoms containing pellets of cocaine. It is also concealed in luggage with false bottoms, in aerosol cans, and sneakers with hollowed-out soles. Sometimes it is converted to liquid and smuggled in bottles of shampoo, mouthwash, and liquor.

By blending shipments within the growing volume of international trade, the Cali cartel greatly reduces the chance of discovery. Interdicting drugs has always been a "needle-in-a-haystack" exercise for customs authorities, but when those drugs are hidden among general merchandise or on the person of international travelers, the task becomes overwhelming. In 1991, for example, 1.8 million containers arrived in the Port of Newark alone, but U.S. customs inspectors there were able to search thoroughly only 15-18 containers a day.

Getting the Goods to the Wholesalers

Once the drug arrives, it must be distributed. The Cali cartel has set up wholesale distribution networks throughout the country and exercises complete control over the New York and Washington, D.C., markets. If a load of cocaine arrives at Kennedy International Airport or at the Port of Newark, one of the 10 to 12 Cali distribution cells in New York receives it. Each cell, made up of 15-20 Colombian employees who earn monthly salaries ranging from \$2,000 to \$7,500, conducts an average of \$25 million of business a month. Each cell is self-contained, with information tightly

The surge in the illicit narcotics trade in Eurasia and elsewhere has been first and foremost fueled by its tremendous profitability.



compartmentalized. Only a handful of managers know all the operatives. The cell has a head, bookkeeper, money handler, cocaine handler, motor pool, and 10 to 15 apartments serving as stash houses.

Communications are conducted in code over facsimile machines, cellular phones, and pay phones. To eliminate any risk of interception, cellular phones are purchased and discarded, often two or three times a week. When a wholesale customer wants to make a purchase, a cell member is notified by a pager system. That cell member proceeds to a public phone and arranges a rendezvous site. He then gets, from the motor pool, a rental car that is returned to the rental agency after the transaction. The transaction itself, including any travel receipts, is logged by the bookkeeper, and the money is turned over to the money handler to be shipped to the financial network set up by the cartel to hide and invest it. A favorite way to ship within the United States is the U.S. Postal Service's "Express Mail."

Such tactics stretch traditional law enforcement surveillance to the limit and beyond. Most national police authorities are finding themselves completely "outgunned" by technologies that are relatively cheap for organized crime but financially out of reach for the law enforcement community. The situation in Poland is suggestive. Between 1990 and 1991, Poland's police budget fell 13 percent. The use of patrol cars was limited to 60 kilometers a day, and police abandoned plans to modernize their vehicles or buy new car radios. Throughout the country only 30 police officials were assigned full-time to antidrug operations.

Once the cartel has received the money for its drug sales, it moves it into and through the legal financial system to conceal its origins. If the Cali cell broken up by federal authorities in December 1991 is typical, the Cali financial network must launder up to \$300 million each year per cell. Money laundering typically involves three independent phases. First, drug proceeds are "placed," or used to make deposits or to purchase monetary instruments or securities that can be turned into cash elsewhere. Second, the money is "layered," or sent through multiple electronic funds transfers or other transactions to make it difficult to track and blur its illicit origin. Finally, the source of the money disappears as it is "integrated," or invested into seemingly legitimate accounts and enterprises.

The revolution under way in the global financial and banking markets has made all three of these jobs easier. Drug traffickers have a vast new array of possibilities for the placement of funds as national currencies become convertible and new and largely unregulated private banking institutions spring up throughout the former Soviet bloc and the third world. Many of the new banks have primitive accounting

practices, no computers, and little or no experience with international banking practices. The integration and increased efficiency of the global banking system allows money launderers to layer money with virtual impunity. The sheer volume of electronic funds transfers makes them almost impossible to track. In 1991, for example, the Clearing House Interbank Payment System handled some 37 billion transactions worth \$222 trillion. Finally, the sudden shift away from state to private ownership throughout the former communist world provides launderers with an array of "front" organizations to integrate their money into seemingly legitimate enterprises. The Cali cartel set up a number of such companies in Hungary, Czechoslovakia, and Poland in 1991.

Of course, the Cali cartel is not the only beneficiary of the changing international business environment. Italian, Polish, Turkish, Georgian, Chinese, Vietnamese, Lebanese, Pakistani, Nigerian, and many other transnational trafficking organizations are profiting as well.

Trends in Global Drug Consumption

Predicting with any precision the character and dimension of the global drug market is difficult. Most drug abuse research has been done on population groups within advanced societies, and epidemiologists are understandably hesitant to apply these findings to the developing world. Too, drug epidemics typically refuse to stay within tidy political, cultural, or geographical boundaries. Islamic fundamentalism seems to help explain why drug abuse is uncommon in Saudi Arabia, but not why more than a million Iranians and 1.7 million Pakistanis use drugs.

But although it may not be possible to anticipate precisely which specific locations are likely to suffer from widespread abuse and when, forecasting the overall trend in global drug consumption is less problematic. The prospect for growing drug abuse worldwide can be correlated with the prevalence of its three requisite ingredients: an awareness of drugs, access to them, and the motivation to use them.

The awareness of drugs has become almost universal. In the third world, demographic pressures are forcing millions of people out of their isolation in remote villages and into large cities, where it is impossible not to know about drugs. And the collapse of the communist regimes in the former Soviet bloc has ended the state's monopoly on information and has made it possible for people to travel freely both at home and abroad. Word of a drug that has acquired popularity somewhere can spread quickly almost everywhere.

Access to drugs is also increasing with the projected rise in production and trafficking. Further, if democratization and economic liberalization persist, individuals will have

greater personal freedom, mobility, and control over their personal incomes, facilitating contacts with drug distributors and their purchases.

People in most third world societies are also increasingly motivated to use drugs. For one thing, the population of the developing world is growing younger. More than half the people in Nigeria and Kenya, and more than 40 percent in Latin America, are under the age of 20—an age group known for risk-taking behavior and the willingness to challenge social conventions. In addition, rapid population growth rates are causing people, particularly young men, to move to big cities. Separated from their families, often unemployed or underemployed, and with little opportunity for schooling, more and more of these disillusioned young people are at great risk of taking up drugs.

Peer pressure and the mass media can also push vulnerable young people to become drug users. Many European and American movies and television programs—even programs like “Miami Vice” and movies like “Scarface” that presumably show that “drug crimes don’t pay”—portray drugs as luxury goods consumed by wealthy Americans. As such, drugs end up serving as status symbols, or as one Nigerian addict recently put it, as a way to “become like an American.”

Finally, the dislocations associated with the end of the socialist experiment and the desperate economic plight of much of the third world are increasing the willingness of people, young and old, to violate the law.

Drug Use on the Rise

What evidence is there that global drug consumption is in fact on the rise? Although the data are soft, health officials around the globe are becoming increasingly alarmed. In Poland, 75 percent of all alcoholics are also addicted to either licit or illicit drugs. Most of these drug abusers in Poland are infected with the AIDS virus as a result of sharing intravenous needles. In Yugoslavia there are 300,000–400,000 addicts, with more than 15,000 in Belgrade alone. Estimates of drug abuse in the former Soviet Union range anywhere from 1.5 million to 7.5 million people. In all three areas, the spread of drug abuse is worst among the young. Almost two-thirds of Polish drug abusers are under 21 years of age.

In Eastern and Southern Asia nearly every country is reporting rising drug abuse. As the Burmese heroin trade has spilled increasingly into the subcontinent, Nepal, Bangladesh, and India all confront burgeoning user populations. In Pakistan, heroin users have grown from a few hundred to more than a million in little over a decade. Drug use in Thailand appeared to be stabilizing after an initial surge in large-scale opium poppy production in the 1970s, but new reports indicate that many villagers are shifting from traditional opium consumption to the more debilitating heroin addiction. As noted, opium and heroin are making a comeback in China, where police estimate that 300,000 use drugs, despite a relentless enforcement effort that featured the public execution of 250 drug traffickers in 1991.

In the barrios of Central and South America, cocaine addiction is becoming more prevalent, with the most worrisome trends in Colombia, Peru, Bolivia, Brazil, Ecuador, and Panama. One of every three secondary school students in Peru uses drugs. In Chile, Argentina, and Brazil, drug consumption is rising most dramatically among young people from upper-income families.

Africa represents the greatest unknown in the consump-

tion picture, though it has virtually all the high-risk factors. Nigeria, Kenya, and South Africa, the wealthiest countries on the Sub-Saharan continent, are witnessing a rising incidence of drug abuse. In South Africa the drug of choice is “mandrax,” a synthetic drug imported from India. In Nigeria and Kenya cannabis is the most widely abused drug, although there have been a growing number of reports of cocaine and heroin use.

The seductiveness of mood-altering substances is age-old and virtually universal. As the conditions that support widespread abuse become more prevalent within much of the global community, the prospect of expanding drug markets appears almost inevitable.

Needed: An International Response

The profound changes connected with the passing of the Cold War era have transformed the drug trade into a transnational challenge of the first order. As with other such challenges—weapons proliferation, disease control, migration, ozone depletion—states can do little on their own to stand up against the rising tide of drug production, trafficking, and consumption.

Acknowledging that the drug trade has become a transnational activity that is outstripping the traditional tools available to governments to combat it has important implications for current U.S. drug control strategy. In 1992, 93.6 percent of the \$11.9 billion national drug control budget was spent on domestic enforcement, demand reduction, and border control. Of the rest, 6.3 percent went to bilateral programs to help governments in source and transit countries fight illicit narcotics. One-tenth of one percent (\$15.5 million) of the total budget supported multilateral drug programs.

What these budget allocations tell us is that U.S. policymakers see drugs as essentially a domestic problem that can be resolved with a national response. At home, it is assumed that large doses of law enforcement, prevention, and treatment programs will erode the market for illicit narcotics. Likewise, along the borders, we seem to believe that a full-scale investment in interdiction will keep traffickers at bay. Overseas, selected governments are enlisted in an American effort to disrupt the production and transit of drugs destined for our shores.

Even if a national strategy to combat the scourge of drugs were to succeed at home, Americans would still face the effects of a flourishing drug trade overseas. As recent events in Peru illustrate, large-scale drug production can disrupt national economies and destroy democratic institutions. When drug trafficking can infiltrate with virtual impunity the commercial conveyances, migrant labor forces, banks, and securities markets that service a global economy, it provides fuel for protectionist forces who seek to slow or reverse the global trend toward greater economic liberalization. Finally, the reduced worker productivity and the public health consequences, including the spread of AIDS, associated with widespread drug abuse jeopardize further the limited development prospects of many third world countries, weakening their potential to become strong U.S. trading partners and stable allies.

The surging global drug epidemic requires an international drug control response and sooner rather than later. What this response should look like and what role the United States should play in it will be considered in the second part of this series. ■

ON THE ROAD TO PARADISE AGAIN?

Keeping Hopes for Russia Realistic

J E R R Y H O U G H

In the year since the tumultuous breakup of the Soviet Union, events in Russia and the other successor states have gradually slipped from the view of the American public. There is a sense, though, that Russian economic reform—let alone that in Ukraine or Central Asia—is not going very well and that the reformers are being threatened by a conservative coalition led by Arkady Volsky.

The former Soviet Union is not likely to remain out of the headlines for long. The Russian “democrats” have been canceling elections and appealing for the dismissal of the freely elected legislature. The Russian “reformist” economic team has combined tight-money rhetoric with a loose-money policy. The disintegration of the Soviet Union left the successor states without governmental institutions that could implement a coherent policy, but these institutions are now being built, and they will be used. The lack of a coherent policy in the face of economic decline cannot continue for long.

This year we have nourished the hope that Russia can pull off a marketization and privatization process even more painful than that imposed on Chile by General Pinochet in the 1970s, while becoming a full-fledged democracy up to the standards of constitutional democracies of the West. In comparison with such unrealistic dreams, events in the successor states are bound to be disappointing. But even more difficult for us, a coherent economic policy is going to be accompanied by and to require tighter integration within the former Soviet Union as a whole.

As Russian policy becomes more coherent, the West will have to make hard choices. The danger is

Jerry Hough, a nonresident senior fellow in the Brookings Foreign Policy Studies program, is director of the Center on East-West Trade, Investment, and Communications at Duke University. He is the author of Russia and the West: Gorbachev and the Politics of Reform (Simon and Schuster, 1990).

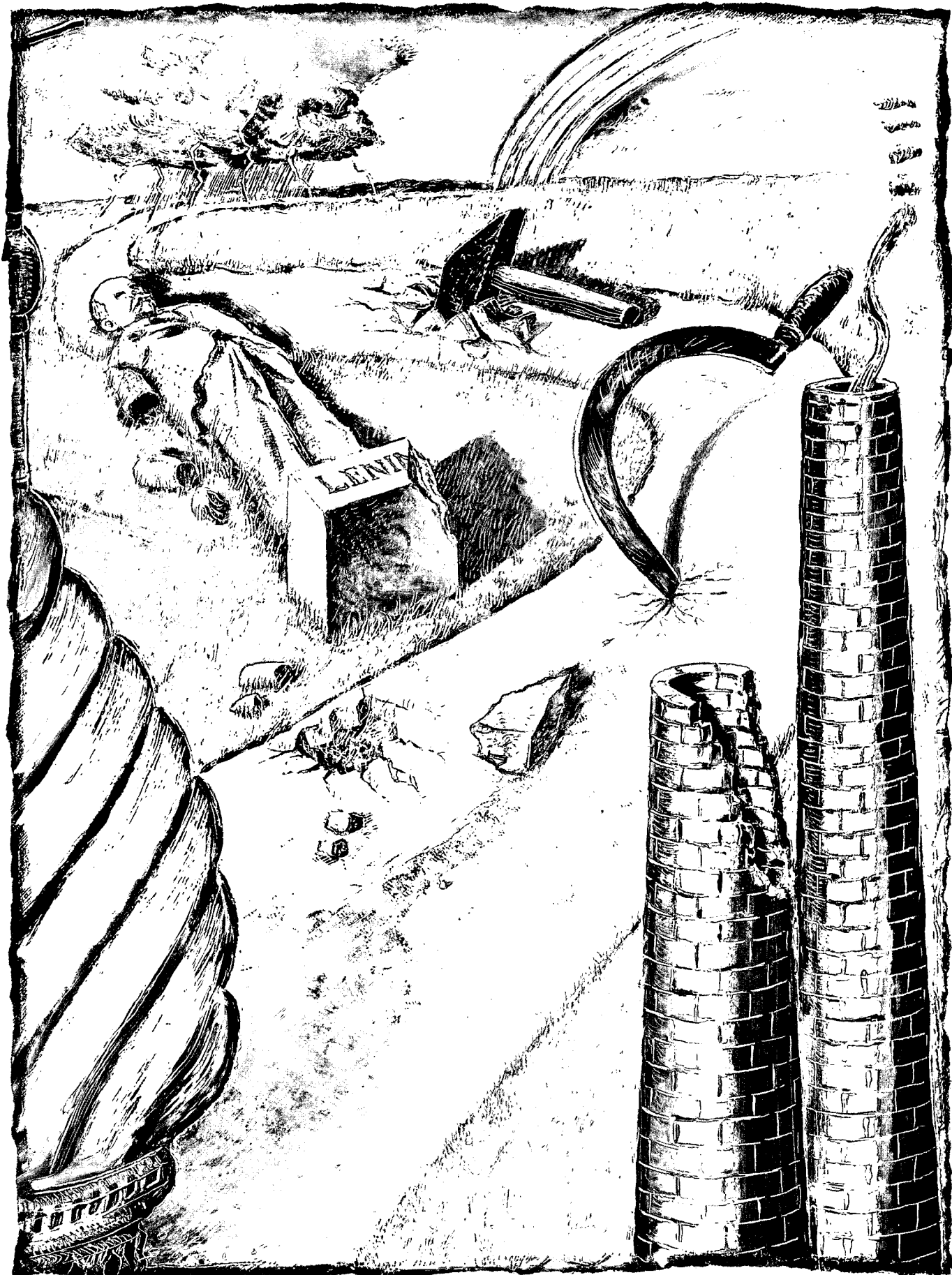
that American policy will have to be decided by a new administration that is strongly within the Wilsonian-Carter human rights tradition, but with an idealized view of events in 1992 and a simplified view of the choices in the Russian policy debates. A realistic policy must begin with a realistic understanding of just what has been going on.

The Gaidar “Tight-Money” Policy

Americans who have been following Russia casually this year have a vague sense of confusion and unease. The pieces of the puzzle don’t seem to fit. Americans who follow Russia more closely and who think through the conventional wisdom differ only in that their sense of confusion and unease is well defined.

The central problem is that during 1992 the economic czar Yegor Gaidar supposedly followed an extremely tight-money, low-subsidy macroeconomic policy of the type endorsed by the International Monetary Fund, but the result was a surge of inflation that threatened to accelerate instead of subside.

How is this anomaly to be explained? Clearly the money supply was expanding rapidly, and someone was responsible. “Villains” have come and gone. Initially it was the State Bank, under the control of the parliament instead of the president, that was issuing money irresponsibly. Then when the State Bank struck back by not issuing money, creating a cash shortage that kept workers from being paid, it was said that the state enterprises were making loans to each other without control. At other times provincial officials—representatives of the old nomenklatura—were the culprits: their failure to transmit tax revenues to



Moscow was causing a revenue shortage and thereby creating a central deficit. Then Jeffrey Sachs discovered that the real source of the difficulty had been the non-Russian republics. They had had the de facto power to create rubles, and they had helped inflate the Russian currency.

All these explanations contained a grain of truth, but none really made sense. Inter-enterprise loans did not create money. The money supply increased when the enterprises received bank loans to pay for wages, taxes, and supplies not provided on inter-enterprise loans. The non-Russian republics could not really create rubles. They were issuing letters of credit and making transfer payments that were translated into rubles inside Russia. But it was Russian banks that honored this paper and created the rubles, not the non-Russians. The State Bank did not make loans, but simply issued money to cover loans and wages already committed—as it was obligated to do by law.

The major loan-making banks were a peculiar kind of commercial bank. “Founded” by major industrial enterprises of an industrial branch in 1991, they were obligated to give loan preference to the enterprises that founded them. One, for example, the “Stankinbank” (the Machine Tool and Instruments Bank) served the industry once run by the USSR Ministry of Machine Tools and Instruments.

If these branch banks really were commercial banks, obtaining their loan money in ways well established in the West and making loans to their enterprises at commercial rates on the basis of potential profitability, their behavior could be discussed in terms of such categories as the interest rates set by the Central Bank and the quantity of money issued by it. But Russian branch banks don’t work like that. Stankinbank, for example, is housed in the same building as the Department of the Machine Tool and Instruments Industry of the Ministry of Industry of Russia. The branch “commercial” banks worked under the direct supervision of the Ministry of Industry. Top IMF officials working with the Russian system could not distinguish between bank and government—because there was no real distinction.

In other respects too, large elements of the old system remain. The Department of Agricultural Machinery and Tractors of the Ministry of Industry, with 100 employees, is a government body that provides policy guidance and conducts “investment policy.” “Autoselkhozholding” (Auto-Agricultural Machinery Holding) is a “private organization” staffed by 500 people who engage in “wholesale trade” and buy supplies and sell them at a 5–6 percent commission. But with the holding company headed by the former minister of the auto industry and located four doors down the corridor from the Department, one can guess the meaning behind the cliché that old supply ties are being maintained through independent managerial inertia.

Now the Ministry of Industry is being split into five state committees—one for industrial policy and four branch committees for the defense industry, machinery, metallurgy, and energy. The committees will be given larger investment funds and larger staff to administer it.

Heavy Industry as the Unemployment Office

For 60 years communist leaders have used the big industrial enterprise as a central instrument of social welfare, and with few functioning alternatives, they still do today. Loans are being made not only to finance production, but also to provide de facto unemployment insurance to workers and to pay taxes to finance local government. Loans continue to be given when the enterprises are bankrupt by any meaningful standard and when they have no hope of solving their problems by normal commercial activity.

The application of profitability criteria to Russian industries, already greatly overstuffed by Western standards, should have dramatically shrunk the work force. Instead, while the labor force has shrunk because of attrition and frustration over low wages, a 20–25 percent drop in industrial production has caused no significant unemployment, particularly in large-scale industry. June graduates from high schools, technical schools, and colleges seem to have found work. The explanation? Loans were being used to pay the wages of those who were not working.

Sometimes factory managers are described as a law unto themselves, protecting their workers and paying them what they want. Banks, it is said, have no choice but to honor managerial commitments. But the banks belie that view on occasion simply by not issuing the requisite cash. On some questions, managers have, in fact, been able to act with arrogance and impunity, but wage increases have not been random. They have tended to vary directly with the recipients’ importance to society—and ability to strike. Hard-currency earners such as coal miners and oil workers receive high wages, while social scientists in the Academy of Sciences receive below-subsistence wages. Insiders assert that local managers are told what wage rates they can establish and these instructions are enforced by the size of loans or allocations provided.

Perhaps the most revealing evidence comes in the way city government is financed. In 1992 rapid inflation forced monthly changes in the budgets of city governments. Yaroslavl, a city of 650,000 people, kept its budget in balance for at least the first four months of the year, matching a precipitous rise in spending with a precipitous rise in tax receipts. Remarkably, the large portion (65 percent) of revenue intended to come from the tax on profits of state enterprises kept pace with inflation during the spring. The enterprises themselves were going bankrupt by any normal accounting procedure, but their “profits” kept rising—so the taxes on them could support the schools, hospitals, and city services of Yaroslavl.

This was a nationwide phenomenon. From March to May the value-added tax remained level at 52–54 billion rubles. Excise taxes declined from 10 billion to 9 billion. Individual taxes rose from 16 billion to 19 billion. But the profit tax more than doubled, from 41 billion to 101 billion. But since the enterprises had huge cash-flow problems, these “profit tax revenues” were being financed in significant part through loans from the branch “commercial” banks.

Such loans were made in different forms throughout the economy. For example, the cost of medicines

produced in Russia rose tenfold during the first quarter of 1992. To cushion the blow on customers and hospitals, the regime increased the price of the medicines sold to them only four times. The regime should have provided a subsidy to the wholesale pharmaceutical distributor—a wholly state institution—to cover the difference, but, to maintain the appearance of budgetary stringency, it did not. Instead, when producers refused to ship medicines, the government told the distributors to go to the banks for “loans” to get the money to pay for the medicine. In Yaroslavl, the debt of the regional distributor rose from 3 million rubles on January 1 to 20 million on April 15. The total budget for medicines for Yaroslavl hospitals for the first quarter was 7 million rubles.

In short, the Gaidar government followed a loose-money policy from the beginning, but put most of the deficit off-budget to create the impression of a balanced budget. Its February 1992 memorandum to the IMF claimed that inflation would soon level off, but even Stanislav Shatalin, Gaidar’s mentor, felt it necessary to write in *Nezavisimaia gazeta* on March 21 that the calculations had no basis in reality and that there would be either a catastrophic drop in production or hyperinflation. So it turned out.

The reasons for the duplicity in Gaidar’s declared economic policy are not clear. Perhaps, as a young macroeconomist, Gaidar had no option but to endorse standard IMF policies and claim he was following them. Otherwise, a person with other expertise would have been chosen for his post. Perhaps the international organizations made admission conditional on the enunciation of certain policies even if they were not being followed; perhaps they virtually compelled Gaidar to say what he said. (In practice, U.S. congressional appropriation of the pledged \$12 billion U.S. contribution to the IMF became politically tied to Russian admission and “aid.”) Perhaps both Gaidar and the international monetary organizations thought the declared policy was a good cover for inflationary price liberalization and that real policy could be made to move toward declared policy once price relationships become more rational. Perhaps Gaidar was so inexperienced that he could not see the outcome of the processes and mechanisms over which he was presiding. We simply do not know.

The Reform Model—Polish or Chinese?

In recent months the Russian and Western press has talked about a loosening of monetary controls. The reporting, however, has been misleading. The big development of the past few months has been a change in the level of honesty, not in the rate of increase of the deficit. Spending is now being put on budget, and the

reality of the deficit is being recognized. There actually seems to be a tightening of money to industry and a rise in unemployment.

The political battle of recent months has centered not on whether to loosen monetary policy, but on whether to continue that policy or to tighten it to correspond with declared policy. The long-term political battle, however, has been over whether to adopt the Polish or the Chinese model of economic reform. The Polish model envisions a complete overhaul of the economy, the sooner the better. The Chinese model implies fairly rapid economic reform in the agricultural, service, and small industry sectors, but much more gradual reform in heavy industry. The debate, obviously, hinges on what to do with heavy industry.

The Polish model was pushed by the young team Boris Yeltsin chose to cooperate with him in breaking up the Soviet Union in 1991. Gennady Burbulis and Sergei Shakhrai handled the political portfolios, Yegor

Gaidar and Aleksandr Shokhin, the economic ones. Burbulis and Shakhrai had virtually no political or administrative experience before the 1989 elections, while Gaidar and Shokhin were very knowledgeable about Western economics but had no experience in the economic and administrative system.

Gaidar and Shokhin both worked as young economists as heads of “laboratories” in the Institute of Systems Research under the leadership of Stanislav Shatalin. Gaidar’s laboratory specialized on macroeconomic questions; Shokhin’s on social problems. When Shatalin moved to the Institute of Economic Forecasting, they followed him. Both were part of the team that put together the Shatalin plan in 1990 and then

developed the economic plan in 1991 that Yeltsin used to attack the Union.

For Russia, a tight-money, low-subsidy, low-tariff policy, intentionally or not (and in Gaidar’s case intentionally), was a policy of deindustrialization. The bloated heavy-industry sector would be subjected to intense pressure—the minister of industry talked about a 50 percent decline in production.

While all the deputy premiers, including Gaidar and Shokhin, were confirmed by the Russian legislature, Gaidar’s declared policy never really had the support of a majority of that body. The Russian parliament elected in the spring of 1990 had two major blocs—Democratic Russia and Communist Russia—each with about a third of the deputies. Enough deputies in the middle joined the Democratic Russia forces to elect Yeltsin chairman of the Supreme Soviet in 1990 by four votes and then to authorize the presidential election of 1991. Nevertheless, they decisively united with conservatives on a number of key symbolic issues and were clearly moderates on reform.

For 60 years communist
leaders have used the big
industrial enterprise as
a central instrument of social
welfare, and with few
functioning alternatives,
they still do today.

The "Businessman's Lobby"

The response of the industrialists to Gaidar's policy was predictable. They resisted the destruction of industry as economically, ethically, and politically inexcusable, and they poured scorn on the inexperience of the Yeltsin team. Their leader became Arkady Volsky and his Union of Industrialists and Businessmen. Volsky, who began his career as an engineer at the Moscow Auto Works, worked from 1966 to 1982 in the defense and machinery industry departments of the Central Committee. In 1982 Yuri Andropov made Volsky his leading personal assistant, but after Andropov's death, Konstantin Chernenko and Mikhail Gorbachev gave him relatively minor posts.

In 1989 Volsky became a deputy of the USSR Congress of People's Deputies. He formed a Scientific-Industrial Union and headed the industrialist forces in the Congress. After the attempted coup in August 1991, he was one of four men named to head the coordinating USSR Committee for the Operational Management of the Economy. In practice, he became its dominant figure.

After the breakup of the Soviet Union, Volsky returned full-time to what was now called the Russian Union of Industrialists and Businessmen. As the leading figures of the Russian government took over the offices of the secretaries of the Central Committee in the Old Square, the Union of Industrialists and Businessmen moved in right next door. In appearance a businessman's lobby, actually the Industrialists' Union was becoming the country's political opposition.

Volsky's political strategy was twofold. First, he worked to unite the industrialists and the trade unions in opposition to deindustrialization. Implicitly and sometimes explicitly, he and his supporters threatened cooperative strike action by the unions and industrialists if economic policy became too harsh.

Second, Volsky organized the centrist forces of the Russian parliament. Two major issues arose—one, the strength of Yeltsin's power vis-à-vis the legislature and, two, the character of economic policy. Volsky put together somewhat different coalitions on these issues and defeated Democratic Russia on both. Indeed, key elements of Democratic Russia broke away and moved toward the center.

In the late spring and summer, Volsky organized the centrist forces formally. In May he created a political party called Renewal. Then he formed a coalition called Civic Union with a number of the factions and parties formerly associated with Democratic Russia or Yeltsin. One, the People's Party of Free Russia, was headed by the vice president, Aleksandr Rutskoi, who had broken the previous year with Communist Russia to support Yeltsin; another was the first major non-

Communist party of Russia, the Democratic Party of Russia, headed by Nikolai Travkin.

The Russian system is like the French in having both a president and a prime minister. Volsky is not trying to replace Yeltsin, but the government beneath him. And, of course, he wants to turn Yeltsin more into Queen Elizabeth than François Mitterrand.

Like all political groups, Civic Union has not been as explicit about its economic program as one might want. Volsky does, however, talk explicitly about the Chinese or the Asian model of reform in preference to the Polish one. (He has visited Japan and Korea half a dozen times each, but refuses invitations to the United States.) What is striking is the extent to which Volsky, who is often described as a conservative on economic policy, has moved the debate about the economy in a reform direction. Almost no one talks openly about returning to the old Soviet economic system. Even *Pravda* writes favorably about China's agricultural reform.

The real problem from our point of view is that Volsky rightly emphasizes that economic integration of the old Soviet Union is vital for the economy. One hopes that the re-integration of the Soviet Union will be done quietly and more or less voluntarily, leaving a confederation in place. The new Ukrainian premier, Leonid Kuchma, once the director of the large Ukrainian rocket plant, is a friend of Volsky's and speaks of the Chinese model and close cooperation with Russia. He is scornful about the introduction of a separate Ukrainian currency. The Lithuanians, in their November parliamentary elections, supported the former communists and rejected Sajudis. Nevertheless, Yeltsin's

decision to leave troops in the Baltics until they treat local Russians well is a reminder that the Soviet army remains intact and stands behind the new policy.

The exact nature of Volsky's policy toward heavy industry is also unclear. In 1992 the former Soviet Union had neither the orderliness of the old system nor real market mechanisms. Capital goods producers continue to ship goods, but pressure for technological improvement (or even the possibility for it) seems absent without investment. Moreover, with production falling, the economy seems to be running down more than being transformed. Volsky clearly plans to try to promote state-directed industrial investment. Certainly the enterprises will issue shares in exchange for investment, and the government will retain control of them. Volsky's dilemma is how to do it without locking industry into the old administrative system.

How Should the United States Respond?

Since many near-term and middle-term scenarios are possible, it is difficult to talk precisely about the proper

Democracy is incompatible
with pure marketization, for
the vast majority of demo-
cratic politics center on efforts
of people to protect them-
selves from the market and to
receive more income or secu-
rity than it would provide.

U.S. response. If the financial chaos continues, talk about a financial stabilization program will remain academic. But the introduction of order will require America to face real decisions. Obviously, if order is introduced by Soviet troops acting in the Baltic states, the U.S. response will be different than if domestic political change in Ukraine brings it into a common economic market.

It is possible, however, to make several general points. First, the old U.S. propagandistic position on the Soviet Union alternated between two inconsistent views. Often we compared the Soviet Union with the United States—to emphasize Soviet political and economic shortcomings. At other times we sneered at it as a third world country. Neither position was right, but the latter was closer to the truth.

In the past few years we have combined an excessive denigration of the achievements of the Soviet Union with the hope that we can force the successor states to embrace democracy (including full national self-determination for ethnic groups), human rights, and free markets over five to ten years. We seldom even recognize the inherent contradictions in these goals, let alone the difficulty of introducing either democracy or free markets, as history has shown in Europe and the third world.

Indeed, we have seen the choice in the Soviet Union as a dualistic one between reform and reaction and have often personalized the choice. For years Gorbachev, Aleksandr Yakovlev, and Eduard Shevardnadze represented in our minds all that was good, and Yegor Ligachev was unfairly demonized. Now Boris Yeltsin and Yegor Gaidar are cast in the “good” role, and Arkady Volsky is the villain.

We must become much more sophisticated. Democracy is incompatible with pure marketization. Indeed, the vast majority of democratic politics center on efforts of people to protect themselves from the market and to receive more income or security than it would provide.

Volsky's ally, Aleksandr Rutskoi, speaks of the need for a “strong, liberal state.” In fact, market economies require orderly, predictable political conditions and reliable institutions that can enforce contracts and adjudicate legal disputes. This aspect of economic reform has been neglected in Russia, and the legal anarchy of the past three years must be ended. It is not clear how much stronger a state Rutskoi has in mind and even less clear whether Volsky shares his vision.

Last October Gaidar explicitly condemned Volsky's embracing of the Chinese model, arguing that the Chinese political system goes with its economic system—the implication being that a freer, democratic state requires a freer market economy. But, in general, Volsky's economic policy is closer to Western social democracy and is less likely to require repression than an extreme market position.

Volsky's Civic Union controls about 40 percent of the deputies of the Congress of People's Deputies and a third of the smaller Supreme Soviet. (The latter will be changed in December to reflect the new balance of forces.) Many elements of its basic program—support for the industrial state sector and for a strong confed-

eration within the old Soviet Union—are attractive to the moderate right, and the Volsky forces almost surely will be able to maintain a working majority in the parliament by maintaining an alliance with them.

Political philosophers have long pointed out the inherent conflict within constitutional democracy between majority rule and minority rights. The American tradition emphasizes the dangers of the tyranny of the majority. In the normal course of democratization in Europe, the gradual and uneven introduction of constitutional limits on the king came before democracy. In her famous defense of authoritarian regimes in 1979, Jeane Kirkpatrick would have been less severely criticized if she had described them as constitutional or semi-constitutional dictatorships on the 18th- and 19th-century European model (and if she had limited herself more clearly to defending such “limited” modern dictators).

There is a strong logic to this sequence. If democracy is introduced when the elite still conceives of government in absolute terms, then elected democrats naturally think they should have absolute power. That is why democracy often leads to extremism and plebiscitary dictatorship in its early stages, and is replaced by some kind of dictatorship. These succeeding dictatorships tend to be less absolutist, and, as a result, the democrats too have a more liberal conception of government in the next phase of democratization.

In Western Europe and Latin America, democratization was a 150-year process. At best, as in England, the reduction of the power of the king and the rise in the influence, first, of the middle class and then of workers was a slow and gradual process. The power of parliament varied greatly over time and by issue. The French process from 1787 to 1958 was more typical in being interrupted by periods of various types of dictatorship.

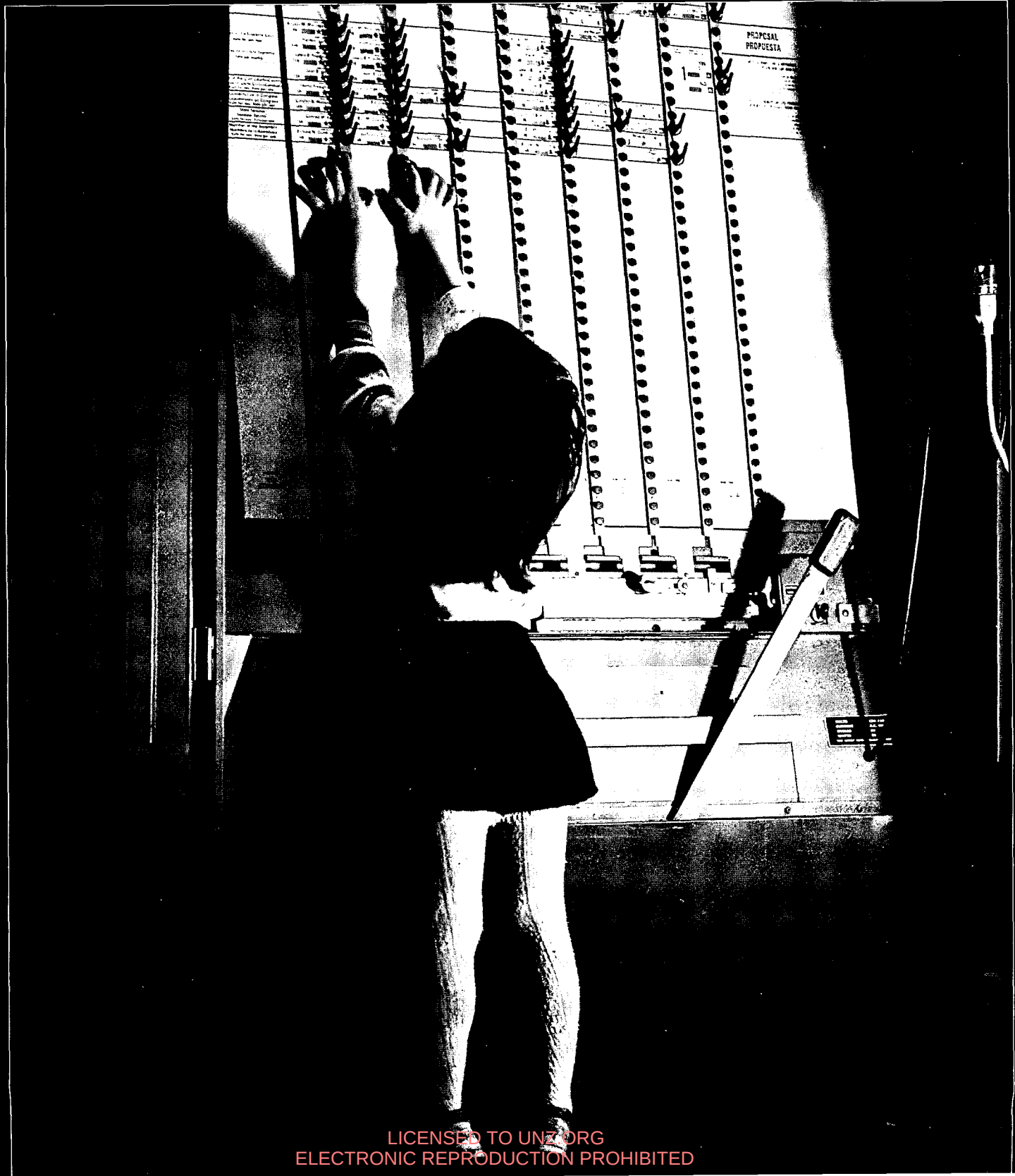
If the successor states to the Soviet Union have the kinds of mixed political systems and economic systems we saw in Europe in the 19th century and in the third world in this century, we should see this as normal, not inadmissible. If full democratization takes 150 years, then Russia began in 1905 and is well along in the process, but it still has a long way to go.

In the 1930s many Westerners read into Stalin all their hopes for socialism and planning. They saw the loss of half the nation's cattle through farm collectivization as a minor cost on the road to paradise. Today many Westerners read into Russian reformers all their hopes for a pure market system—and see the loss of half of industry as a minor cost on the road to paradise.

The American tradition has emphasized gradualism, pragmatism, and constitutional rights. We have lived with regimes in the Pacific, in Asia, and in Latin America that do not correspond to Western political and economic models. We nudge them in the direction of those models, but we understand that the process is a long one. If Russia is willing—as it seems—to join the Western geopolitical community, we need not treat it differently than we do other countries making the same journey. Given our long-term geostrategic and economic interests, it would be foolish to do so. ■

An Immodest Proposal

LET'S GIVE CHILDREN THE VOTE



LICENSED TO UNZ.ORG
ELECTRONIC REPRODUCTION PROHIBITED

It is a melancholy object to those who walk through this great town . . . when they see the streets . . . crowded with beggars of the female sex, followed by three, four, or six children, all in rags, and importuning every passenger for an alms. These mothers . . . are forced to employ all their time in strolling, to beg sustenance for their helpless infants, who, as they grow up . . . turn thieves for want of work. . . .

—Jonathan Swift
“A Modest Proposal”

Jonathan Swift proposed relieving the public of the necessity of encountering impoverished Irish children by selling the children, at an early age, to be prepared as a delicacy for those with the means to buy them. My proposal to address the escalating poverty rate among American children is more immodest. All we need to do is give them the vote.

Such a proposal would be merely facetious were it not for the fact that today's elected officials, to be successful, must attend strictly to the short-term interests of those directly engaged in the political process. It is not simply the spend-now-pay-later reelection strategy that has become commonplace in Washington. It is not just the pollute-now-conserve-next-century policy choices that remain in vogue. It is not just future generations who are being asked to pay for the pleasure of today's voters. It is the country's own children who are being asked to sacrifice right now.

One need only compare the welfare of children with that of the elderly to see both the extent of the sacrifice being exacted of children and the importance of the ability to vote. Both age groups depend on government programs. Both have a claim on public resources. Both are represented by organizations that state their case before Congress, state legislatures, and executive departments. But only one age group has the vote.

Last May the House Ways and Means Committee released the 1,888-page 1992 “Green Book” on social welfare policy in the United States. It shows that the poverty rate for the elderly fell from 35 percent in 1959 to 25 percent in 1970, and then fell again to 11 percent in 1989 before turning back up slightly to 12 percent during the recession of 1990. Over the past two decades the decline was a remarkable 56 percent. Meanwhile, the poverty rate among children under the age of 18 has been growing—from 14 percent in 1969 to 21 percent in 1990, an increase of 50 percent. The two poverty rates have been changing at roughly the same rate, but in the opposite direction.

Some will argue that the increase in poverty among children is due not to government policy or to voter self-interest, but to social and economic trends beyond government's reach: the decline in hourly wages paid to those without a high school education, the growth in female-headed households, the increase in job competition from workers abroad, and immigration, legal and illegal, from impoverished countries in Asia and Latin America.

Certainly these trends affect children. But is government helpless to respond? The United States is not the only industrial country facing a slowdown in its

productivity rate, fierce competition from abroad, and dramatic changes in family life. Yet the poverty rate among children in seven other roughly comparable countries—Australia, Canada, France, Germany, the Netherlands, Sweden, and the United Kingdom—averaged just 7.4 percent in the mid-1980s. The 20 percent rate in the United States is due more to its unique government policies than to any distinctive economic or social realities. Before we take American voters and their elected representatives off the hook, let us take a look at U.S. government policy for children and the elderly.

Spending on the Elderly and on Children

The Great Society built by Lyndon Johnson and Richard Nixon was just that for America's growing and increasingly politicized elderly population. Between 1965 and 1975 federal spending on the elderly nearly tripled, from \$71.3 billion to \$192.9 billion (all amounts in this paper are in 1990 dollars). Per capita spending on the elderly more than doubled, from \$3,860 to \$8,500.

The main vehicle for the expansion was the retirement provisions of social security and related pension programs, which were gradually expanded until by 1975 they covered almost all retirees. Benefits were also steadily raised. When, in the early 1970s, they reached their highest point ever relative to worker wages, they were indexed to subsequent increases in the cost of living. The age of eligibility was also lowered from 65 to 62, though benefits were lower for early retirement.

Beginning in 1965 the medicare program provided broad-gauged health insurance for all retirees eligible for social security. In addition, the elderly benefited from the 1974 supplemental social insurance program (SSI) for the blind, deaf, and disabled and from the 1965 medicaid program of free medical services for both the elderly and nonelderly poor.

By 1975 many federal programs were also serving children. The main cash benefit program to female-headed households, Aid to Families with Dependent Children (AFDC), in place since the New Deal, grew rapidly as court decisions and administrative changes liberalized access to benefits. A supplemental food program was created in 1966 for women, infants, and children (WIC); the food stamp program was established on a national basis; a more flexible set of housing assistance programs replaced the huge public housing projects of the Truman and Eisenhower years; and an earned income tax credit supplemented the income of the working poor. Finally, some families had access to two programs also of benefit to the elderly—SSI and medicaid.

But if the number of programs for children seems impressive, the money spent on them was less so. Altogether, federal spending on children in 1975 was \$42.3 billion in 1990 dollars, or 1.2 percent of GNP—compared with 5.4 percent for the elderly.

Comparing dollars or the percent of GNP spent on welfare programs for the two age cohorts is one way to measure the impact of the programs. There are three others, none of them perfect: spending per age-

Paul E.
Peterson

Paul E. Peterson,
formerly director of the
Brookings Governmental Studies
program, is Henry Lee
Shattuck Professor of
Government and
director of the Center
for American Political
Studies at Harvard
University. This article
is adapted from “An
Immodest Proposal,”
which appeared in the
fall 1992 issue of
Daedalus, the journal
of the American
Academy of Arts
and Sciences.

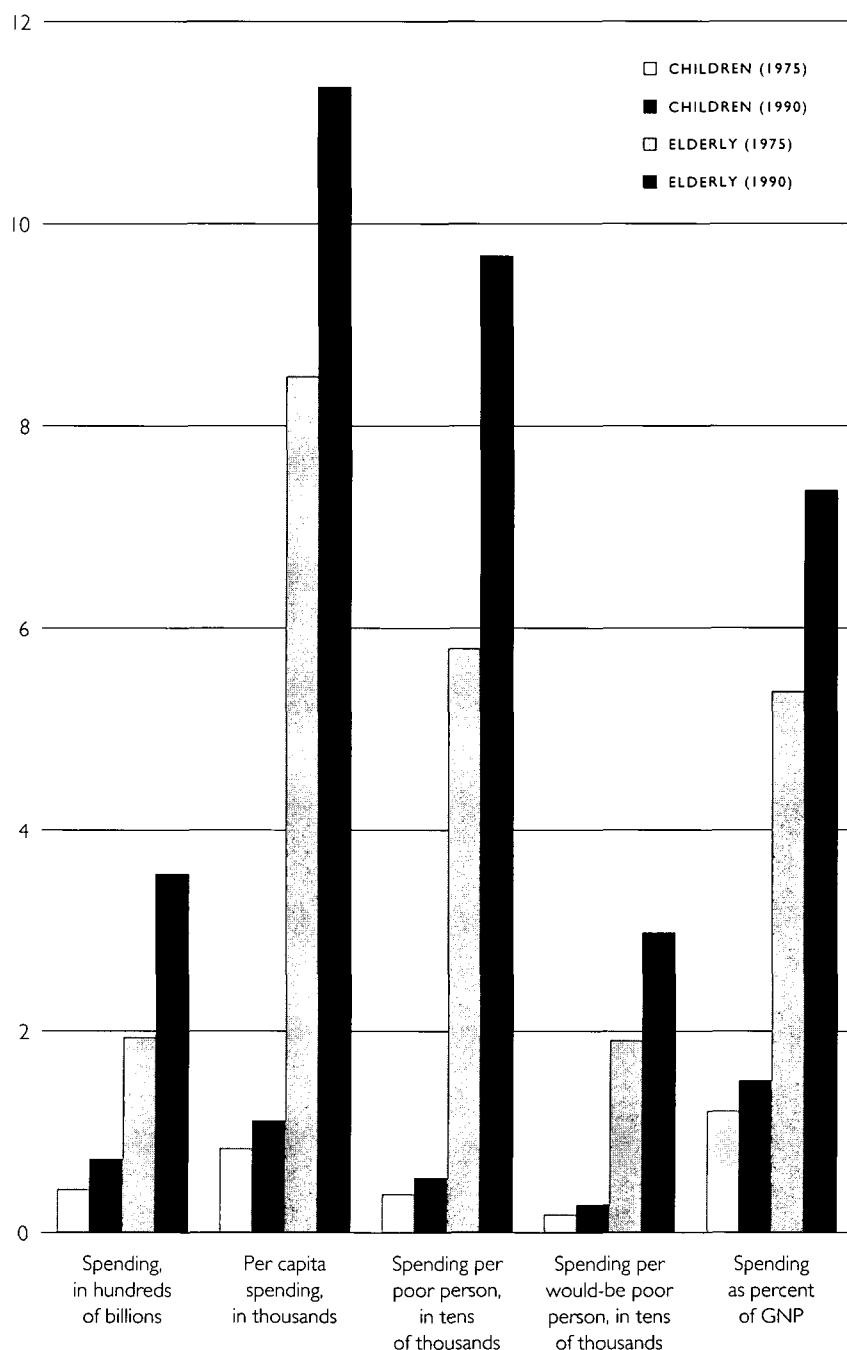


Figure 1. Social Welfare Spending on Children and the Elderly, 1975 and 1990

CONSTANT 1990 DOLLARS

cohort member, spending per poor member of the age cohort, and spending per cohort member who would have been poor but for the welfare program.

Spending per cohort member takes into account differences in the size of the two groups. Spending per poor person in each cohort takes into account the fact that many of the middle-class and wealthy elderly appear to have little need for welfare and identifies the effect programs would have had if spending had been targeted on the most needy. The best measure is spending per member of the cohort who would have been poor without the welfare programs. Yet even this measure takes no account of the fact that many welfare programs are not narrowly targeted on the would-be poor and that many would-be poor would have found alternative sources of income, such as working or saving, had the program not been in place.

But no matter what estimate is used, government programs had greater impact on the elderly than on children (*figure 1*). The sums available for the would-be poor elderly were 10 times those allocated to programs for children. Had the programs for the elderly been perfectly targeted, the would-be poor would have received in cash or in kind an average of nearly \$20,000 per person; would-be poor families with children would have received around \$1,800 per child.

One might have thought that structural flaws and imbalances overlooked in the rush to build the Great Society would have been corrected over the years. But what was in place by 1975 is pretty much what exists today. Jimmy Carter's pro-family initiative was aborted by legislative disputations; Ronald Reagan's effort to turn family-oriented welfare policies over to the states was rejected by Congress; the Family Support Act of 1988, celebrated at the time as welfare reform, actually made only minor changes in welfare policy; and George Bush aggressively pursued a policy of resigned acceptance of the status quo.

Not that spending has remained constant. For each age cohort, it has grown a little more than 50 percent per would-be poor person. But the progress remains extraordinarily unbalanced. The average spending per would-be poor elderly person grew from \$20,000 in 1975 to \$30,000 in 1990, while the average per would-be poor child climbed from about \$1,800 to \$2,700.

It does not take an advanced mathematical mind to conclude that slowing the increase in benefits to the elderly just a bit could have tripled the fiscal attention given the problems of poor children. Had cuts in social security, medicare, and other benefits been designed to limit their impact on the low-income elderly, the growth in poverty among children could have been avoided without slowing the decline in poverty among the elderly.

Differences in Program Design

Even more important than the differences in spending for children and for the elderly are differences in the way their programs are designed. Programs for the elderly come out on top every time. The elderly, for example, tend to receive their benefits in cash rather than in kind. Receiving benefits in cash gives senior citizens the freedom to buy what they want, when

they want, where they want, from whom they want. In 1990 the elderly got two-thirds of their federal benefits in cash; families with children, 41 percent.

In addition, almost all benefits to the elderly are indexed to rise with increases in consumer prices, thus preserving their value when inflation is high. Many children's programs, including the earned income tax credit, food stamps, and SSI, are also indexed. But the largest, AFDC, is not, and benefit levels fell 35 percent between 1975 and 1990.

Benefits for the elderly also tend to be given as a matter of right rather than as a handout. Social security, for example, is viewed as an "insurance fund" to which the elderly contribute during their working years and from which, in retirement, they receive benefits according to their contribution to it. In reality, the designation of social security and medicare as social insurance is a polite fiction. The money is spent by the government as fast as it is contributed, for purposes that often have nothing to do with retirement. The average couple retiring in 1981 contributed enough to social security during their working years to have earned four months worth of medical benefits and three and a half years of their retirement pension. For the remaining 13 years of their life span the couple is simply enjoying a gift from working Americans.

No comparable fiction covers children's programs. Although programs for children and for the elderly fall under the general rubric "entitlement programs," the so-called entitlements of children differ markedly from those cherished by the elderly. To establish the eligibility of a child's family, its head must show that the family has virtually no other livelihood. He or she must visit the local office of a government agency, wait patiently in line, and reveal the family's complete fiscal record to a government official whose duty it is to ferret out ineligibility, misrepresentation, and fraud. To receive cash benefits, the applicant must prove that the family does not own a home, has virtually no savings, and has hardly any income. One statistic not in the Green Book is the average number of return trips it takes to supply the necessary documentation.

The Virtues of National Benefits

Benefits received by the elderly are likely to be both nationally standardized and dispensed by a single federal agency. Retirement and health care benefits are set in Washington and are identical nationwide. Senior citizens can choose where to live without regard to government policy. They can move to another state or city to get a better job, live closer to their children, or simply avoid the cold blasts of winter, without jeopardizing the size or delivery of their social security check and or medicare benefits.

For families with children the situation is different. Only the earned income tax credit is nationally standardized. Benefit levels for other major programs—AFDC, medicaid, food stamps, SSI, housing assistance, home energy assistance—vary from state to state. In the case of AFDC the cash benefits can be five times as much in one state as in another. Eligibility requirements vary too: a family can be eligible in one state and not in another.

Benefits determined by states are also lower than they would be if they were determined in Washington. The three children's programs whose policies are largely or entirely set at the national level—food stamps, the earned income tax credit, and medicaid—have grown substantially over the past 15 years. But AFDC, which is state-determined, has fallen 35 percent, at least partly because of the effort states make to avoid becoming welfare magnets that attract the poor from other parts of the country. Similarly, the national contribution to the SSI program has kept pace with inflation over the past 15 years, while state supplements fell 60 percent between 1975 and 1992.

In addition, the most important programs for the elderly have a uniform set of rules nationwide. That means that the elderly need not figure out anew how to receive benefits every time they move. It also means that rules determining eligibility and procedures for applying are widely disseminated and generally known by senior citizens.

Most children's programs, however, are administered by state and local officials, subject to some federal regulation. Any move across state (sometimes local) boundaries requires a recipient to reconnect to services—in offices whose name and program titles vary by state (sometimes by locality). Procedures, of course, and waiting periods are different in each state.

A Nearly Perfect Benefit Program

A politically powerful group is likely to insist that government benefits be concentrated in as few programs as possible. The more programs there are, the more difficult it is to ascertain eligibility, estimate potential benefits, figure out procedures, and find out where to apply. More programs mean more agencies, more application forms, more long lines.

The simplicity of programs for the elderly is the envy of children's advocates. Two programs, social security and medicare, account for 80 percent of the benefits distributed to the elderly. The largest program for children, AFDC, provides 24 percent of the benefits. Food stamps provide another 19 percent; medicaid, 18 percent; housing assistance, 9 percent; WIC, 5 percent; EITC, 5 percent; and a host of other programs, the remaining 20 percent. A reform urgently called for by welfare advocates—and implemented by a few localities—is a one-stop welfare service that would at least allow needy families to go from one agency to another within the same building rather than all over town. The elderly need not use their lobbyists for such a small reform.

Ideally, from the recipient's point of view, government benefits should supplement, not substitute for, resources recipients have acquired on their own. Recipients do not want their benefits to depend on their willingness to forgo earnings, sell property, dissipate savings, or lose interest due on investments.

In this regard, the elderly have done well, if not perfectly. They may keep their savings, dividends and interest, and homes while still receiving their medicare and social security pension. Their benefits, however, are not entirely supplemental. Couples must pay taxes on half their social security benefits if their income

(counting half their social security benefits) is greater than \$32,000 a year. In 1992 people who retired at age 65 and were not yet 70 were permitted to earn \$10,200 (the amount is indexed from year to year) without penalty. For every dollar earned above that, benefits were reduced 33 cents. There is, however, no restriction on a spouse's earnings, and, after age 70, none on earnings at all.

While programs for the elderly are almost entirely supplemental, children's programs are mainly substitutional. Families are not eligible for AFDC if they have savings of more than \$1,000, a car worth more than \$1,500, or a home beyond a given value (that varies from state to state). After a four-month transitional period, every dollar earned in excess of \$120 a month by an AFDC family reduces benefits by the same amount. The family is allowed a further exemption of \$100 a month for child care expenses. In other words, the typical AFDC family may receive all their AFDC benefits even if they earn \$2,640 a year. In general, for every dollar above \$2,500 earned by a characteristic poor family, benefits are reduced by about 50 cents.

Medicaid benefits supplement an impoverished family's income in some states but not others. In general, medicaid covers 70 percent of the children under age five living in poverty and 55 percent of the children between the ages of six and eighteen, regardless of earned income. Medicare, by contrast, insures more than 95 percent of the elderly.

Pro-Choice Elderly

In-kind benefits are most popular with beneficiaries who are allowed to choose the providers they want. Choice in the delivery of social services encourages competition among providers, ensuring that they will be sensitive to consumer expectations.

Unless the cost of the service is limited by government fiat, a choice-based system is likely to be expensive, as recipients seek services from providers who give high-quality service. But capping the cost of a choice-based system is unpopular with service providers, who must compete for customers in a cost-contained system that forces increasingly efficient service delivery or smaller profit margins.

Choice-based systems have other apparent disadvantages. They permit the consumer to choose even when a government official might make a better choice. Also, the availability of choice is likely to create a wide variety in service delivery, increasing the chances for unequal service provision.

Medicare, by far the most important in-kind benefit for the elderly, provides almost complete flexibility in the choice of doctor, hospital, and type of service. In addition, elderly patients may, without jeopardizing their government benefit, pay for whatever supplemental services they wish, either with private insurance or from personal means. The medicaid program, of increasing importance to the indigent aged, is more restrictive but still gives recipients a fair amount of choice.

The elderly have succeeded in securing choice in medical service even though a choice-based system greatly increases costs. When medicare and medicaid

were inaugurated in 1965, the overall cost of medical services in the United States was 6 percent of GNP; by 1992 that figure had risen to 13 percent of GNP. If the elderly had not had the political power to demand choice in medicine, restrictions on choice would almost surely have been imposed to contain these rapidly rising costs.

Children have much less choice in selecting their service providers. For the most part, families with children must accept the public housing, family planning services, drug rehabilitation program, and most other in-kind services that government officials decide is appropriate for them. Only in the case of medicaid do needy families have a fairly broad choice in service providers. And it is the choice-based character of medicaid that explains why it is the fastest-growing of programs serving the poor.

The choice children have in selecting medicaid services may, ironically, be attributable to the power of the elderly. Of all federal programs, medicaid is the one in which benefits are shared most equally between families with children and the elderly. In 1990, 29 percent of medicaid spending was on the aged, 24.1 percent on poor families with children. Is it accidental that the one children's program with choice is also one on which the elderly depend?

The Design of Public Education

Public education, the largest of all children's programs, has several qualities that have made it as popular among families as social security and medicare are among the elderly. Just as every worker is entitled to social security, every child is entitled to a public school education. And, like social security, most members of the age group receive the service. Only 11–12 percent of school-going children attend nonpublic institutions. Finally, public schools are financed almost as generously as social security and medicare. In 1990 the cost of public education amounted to 4 percent of GNP, and the average spending per pupil was \$5,266.

But in other respects public education looks like a typical children's program. There are no national standards; there is no uniform level of service across the country; the federal fiscal contribution is but 6 percent of the total cost; and the administrative arrangements are complex and involve federal, state, and local officials. The benefits, furthermore, are substitutional, not supplemental—either children attend a public school or they attend a private school whose costs are paid entirely by their families.

Finally, unlike senior citizens, children and their families have little choice in the schooling they receive. Only by choosing a city, town, or neighborhood can a family choose a school. Once a place of residence is chosen, children must attend the neighborhood school (or the nonneighborhood school) to which the system has assigned them.

Restricting choice in elementary and high school education benefits many political interests. It insulates school administrators and school teachers from the uncertainties of competition. It creates a uniformity of (admittedly low-quality) service; it makes possible, in theory if not in practice, the racial and ethnic integra-

tion of pupils; it preserves the wall between church and state; and it provides the infrastructure for instilling a common, if watered-down, culture.

Yet if children had the vote, they would probably demand greater choice over the schools they attend. Indeed, as soon as young people do get the vote, they enjoy much more choice in selecting their educational services. While children must attend the public school assigned to them before age 18, almost the day they become part of the voting public they win the right (provided they are qualified for admission) to choose where to pursue their education—public or private college, university, junior college or proprietary school. Before 18 they must pay for any private education they select. After 18 young people from low-income families are eligible for grants—delicately called Pell grants rather than tuition vouchers—paid to the public or private college of their choice. Young people from middle-income families receive heavily subsidized loans that can also be used at the college a student chooses.

Before 18, the child attends a school financed by state and local funds that vary widely from place to place. After 18, the young person is eligible for federal benefits that are uniform nationwide and that do not depend on place of residence. Before 18, public money cannot be used for education in a religious institution. After 18, constitutional qualms disappear, and federal funds can go alike to secular and sectarian institutions. Before 18, public funds are a substitute for private funds. After 18, they are supplemental—public and personal monies may be used together to buy a college education.

Most states expressly prohibit the 25 percent of young people who leave school before getting a high school diploma from studying for that diploma in a junior or community college. These high school dropouts must instead either return to the local school they hated, work in a hamburger stand, or wander the streets. After they turn 18 (that is, after they can vote) they may attend a publicly subsidized junior or community college, and, eventually, about one-third of them do find a way to get the equivalent of a high school diploma in some other educational setting.

Public school officials have campaigned hard and successfully on behalf of these laws, which prevent children under age 18 from getting a subsidized education outside the public school. As long as children cannot vote, these educators can deny students' choice and preserve their own monopoly. It is hard to believe that these laws would survive if children had the vote.

If Children Had the Vote

It is conventional wisdom to speak of the voting power of the elderly, the clout exercised by the Association for the Advancement of Retired Persons, the political inviolability of the social security and medicare programs, and the increasing size of the elderly population. But in 1990 there were twice as many children under the age of 18 (65 million) as senior citizens (32 million). If children were enfranchised, fundamental public policy changes would certainly follow. Groups representing children would immediately acquire status and power, they would frighten politicians with organized

letter-writing campaigns, they would demand a bigger share of the welfare pie, and they would insist that programs for children be redesigned.

If children had the vote, five changes in public policy might well be anticipated—not instantly, but eventually. First, benefits to children would become a matter of right rather than a public benefaction. They would become nationally standardized, indexed, nationally administered, simple, and supplemental (instead of substitutional), and would offer choice in selecting a service provider. That would probably entail a substantial program of family allowances, similar to those in Europe, that would go to all families and would be independent of family earnings.

Second, a system of national health insurance would extend to all households the medical benefits now enjoyed by those over age 65.

Third, the major in-kind public service to children, the public school, would no longer be provided by a government monopoly. Families would receive from the government a grant that, together with their own

One need only compare the welfare of children with that of the elderly to see both the extent of the sacrifice being exacted of children and the importance of the ability to vote.

resources, they would use to buy the type and quality of education they prefer.

Fourth, both the health and educational systems would be capped with overall limits on the amount and quality of service that could be provided by the government.

And finally, retirement pensions for the elderly would be scaled back, but permission to earn additional income between the ages of 65 and 70 would be granted. The argument would be that just as family allowances should not restrict family heads from working, neither should pensions for the elderly restrict their participation in the labor market.

I do not specifically recommend these policy innovations, but neither am I alarmed by them. What is alarming is the current imbalance in the structure of the American welfare state and the nation's political incapacity to do anything about it. I am reluctant to propose what in ordinary circumstances would be hardly more fantastic than the "modest proposal" made by Jonathan Swift. But given the country's propensity to eat its future, it may be possible to avoid actions tantamount to Swift's own proposal only by giving children the right to vote. ■

WHO ARE THE NATION'S "TRULY POOR"?

PROBLEMS AND PITFALLS IN (RE)DEFINING AND MEASURING POVERTY

Twenty-five years ago the federal government officially adopted its current measure of the poverty rate, a measure that has survived numerous attacks and both official and unofficial attempts to change it. This past year, in response to congressional directives and with the support of the Bush administration, the National Academy of Sciences brought together a panel of experts to revise it, with a view to either replacing it or supplementing it with other indicators of destitution.

Revising the official measure will be controversial. Movements in the poverty rate are key to evaluating the performance of political administrations and the health of the economy. Numerous pieces of legislation use the poverty measure to allocate federal funds and determine eligibility standards for receiving public benefits. Important interests—states, localities, social service organizations, and benefit recipients—stand to gain or lose from any change in the definition of poverty.

The official poverty statistic is also a symbol with far-reaching ideological and political implications. Conservatives find their interests best served by a low poverty rate, one that can muffle claims of social distress and counter calls for increased public spending. Republicans, having controlled the White House for 20 of the past 24 years, want a measure that shows poverty falling over time—or at least not rising so fast. With official U.S. poverty standing at over 14 percent, more than 2 percentage points higher than it was in 1979, those seeking a smaller public sector find much to fault in the current measure.

Liberals cite high and rising poverty as the primary manifestation of the nation's social problems and charge that it undermines efforts to reduce crime, substance abuse, teen nonmarital parenthood, and infant mortality, and to improve declining student achievement. The high rate of poverty among people of color has suggested to many a link between increasing poverty and deteriorating race relations. The past decade's growth in the poverty rate has spurred calls for increased social spending and strengthened those who support affirmative action measures.

A final source of controversy is that the official poverty measure is an arbitrary construct based on many social judgments about economic needs and well-being. What is an "acceptable social minimum level of living"? What is to be counted in comparing the well-being of people who live in widely varying family types, regions, and neighborhoods? Few of these judgments have, or can have, a reliable scientific basis. Most ultimately require political decisions, a difficult situation for the National Academy panel.

A Fragile Social Indicator

By the official measure, an American family is "poor" if its annual cash income falls below a specified income cutoff that varies with the size and structure of families. By showing the number and demographic composition of the nation's families (and individuals or chil-

Poverty Rate Grows for Hispanic Children

al Poor Said More Likely to Face Long-Term Woes

es of the Union

IE

*ITHMETIC
= POVERTY*

*From GOP,
A New Look
At Poverty*

*Group Tries to Hurdle
Gulf Between Parties*

*HE ELDERLY ARE REALLY
POORER THAN OTHERS*

ly Says Poverty Rising Fastest Among Whites

on-Hispanic Whites a Majority Among the Poor in 35 States, Think Tank Reports

**COUNTING THE POOR
—WITH AN
ANTIQUE CALCULATOR**

**U.S. Poverty Rate Up;
Median Income Falls**

Census Finds First Increase in Poor Since '83

More Children Are Sinking Into Poverty

Who Is Poor?

Children in Poverty: 1 Million More in 80's

dren) in poverty each year, the official measure charts the nation's "progress against poverty" and the changing race, age, and family-structure mix of its poor.

Both the income measure and the poverty cutoff line have come under heavy fire from critics, and both are likely targets for revision by the National Academy panel. The annual cash income reported in the Current Population Survey is taken by the Census Bureau at face value, though it probably fails to include most income earned "off-the-books" or illegally. It also misses all "income" in the form of barter ("You take care of my kids today, and I'll give you some vegetables from my garden.") and gifts. Cash transfers such as welfare benefits are included, but "in-kind" benefits, such as food stamps, housing and medical care benefits, and nutrition subsidies, are not. Tax payments are not subtracted. Income from dividends, rent, and interest is counted; capital gains income and fringe benefits are excluded. Holdings of financial wealth, consumer durables, and housing assets are not even considered. In short, annual cash income neglects a variety of things that contribute to a family's well-being.

The poverty cutoff line is also open to serious question. The income level taken as a socially accepted minimum is based on a 1955 estimate of the cost, for families of various sizes and types, of a minimum level of food. On the basis of crude evidence that 1950s spending on food typically absorbed about a third of a family's budget, that estimate is then multiplied by three. So defined, the poverty line is not affected by a doubling or a halving of the average income of Americans. It is an absolute concept, in spite of the view of many that the definition of a poverty cutoff should reflect the average income in the society. Moreover, critics question why today's official poverty measure should be based on preferences and consumption options of a quite different era. They also challenge the "minimum necessary" standard as being too low and the "blow-up factor" of three and the family size adjustment as arbitrary, dated, or inconsistent with research findings.

How to Measure Economic Well-being?

A yet more fundamental—and controversial—question is whether the official poverty measure reliably reflects the economic status of a family. Annual cash income is a notoriously transitory indicator of economic position. Income can fluctuate widely from year to year, especially among some families that, by any standard, are quite well-to-do. Self-employed business people are a good example. A bad year can well result in a report of zero (or even negative) income that places the family in the poverty category, regardless of its consumption spending or its lifestyle.

Researchers have tried to develop more reliable indicators of economic well-being. Susan Mayer and Christopher Jencks, for example, look to the ownership of consumer durables and other consumption items. Others use family income averaged over three or four years. Although a measure of that sort is more likely than annual cash income to reveal a family's "true" economic position, the Census Bureau does not yet routinely collect such data.

Annual cash income fails to reflect the permanent

capabilities and earning power of families in other ways as well. Three examples will make the problem clear.

First, take two families, both with little education and poor skills. In the Jones family, both the husband and wife hold full-time jobs, and their teenage son works part-time on weekends. Although poor in skills and education, the Jones family escapes poverty. In the Smith family, by contrast, the husband works full-time, the wife stays at home, and the teenage son does not work at all. The Smiths' annual income falls below the poverty line. These families are identical in size and structure, but only the Jones family, by working more, escapes poverty. It is legitimate to ask: "Should the official poverty measure count as poor families who could be earning more if all members worked and not count as poor otherwise identical families, all of whose members do work? Should the strength of one's aversion to work count in measuring poverty?"

Second, the Cartwright family, a father and mother, neither of whom finished high school, and two children, lives in Louisiana. Mr. Cartwright has been out of work for a long time, and the family is eligible for Aid to Families with Dependent Children. Welfare is so low in Louisiana, however, that the Cartwrights have decided not to accept it and the restrictions that accompany it. Instead, Ms. Cartwright works as a waitress, and Mr. Cartwright works in a gas station on weekends while seeking full-time work. Together with their son's part-time earnings, the Cartwrights have enough income to escape poverty. The Epson family has the same characteristics as the Cartwrights, but lives in California. California's AFDC benefits are more generous than Louisiana's, and so the Epsons collect welfare. Neither of the Epsons works (if they did, they could lose their benefits), and their cash income, including AFDC, is less than the poverty line. Again, it is legitimate to ask whether the poverty measure should count as poor those families who face and respond to high work disincentives (caused by, say, relatively generous welfare benefits), and exclude those whose available benefits are low, but who work themselves out of poverty.

Finally, what if the Cartwrights failed to earn enough to escape poverty while the Epsons' welfare benefits plus some interest and dividends were sufficient to lift them out of poverty? Should the poverty measure count as poor those families for whom generous benefits are not available and exclude identical families who receive more generous benefits?

Anomalies in the Official Poverty Measure

The official poverty indicator is geared to measure the extent and composition of the nation's "cash deficient" population in any given year. If that is what one wants in a national poverty measure, it probably receives a marginal passing grade. But if one prefers a poverty measure that reflects the level and composition of those with deficient long-term capabilities to earn income, the official measure leads to several anomalies. For example, independent law or business school students are likely to be counted as poor despite their enormous earnings potential. As a result, the poor are recorded as being younger and more educated than they really are.

Similarly, some families (for example, those headed

Robert Haveman is John Bascom Professor of Economics and Public Affairs at the University of Wisconsin-Madison. He is on the staff of the Robert M. La Follette Institute of Public Affairs and the Institute for Research on Poverty at the university.

HOW EARNINGS CAPACITY POVERTY IS MEASURED

Family earnings capacity is an estimate of the capability of the head (or head and spouse) of a family to earn income if working at full capacity, adjusted to reflect the reality that illness, disability, unemployment, and child care responsibilities may keep all working-age adults from either working or working at capacity. The actual procedures are as follows. First, the earnings of all full-time, year-round workers in the Current Population Survey are related statistically to a variety of their characteristics, such as race, gender, education, age, and health status. Then, using these estimated relationships, the amount that could be earned by each adult if he or she worked full-time, year-round is calculated. That figure is adjusted downward for the time that the individual either sought work but could not find it or could not work because of health problems. After the individuals are collected into their families, their individual earnings capacities are summed. The resulting value for each family is then adjusted downward to reflect the costs of the child care that would have to be purchased if all the adults were to work to capacity. This adjustment reflects the number and ages of the children and an estimate of the per hour costs of child care. The result is taken to be family earnings capacity. When this amount fails to exceed the family's poverty line, the family is labeled "earnings capacity poor."

Table 1. Official and Earnings Capacity Poverty, 1973–88

	1973	1988	PERCENT CHANGE 1973–88
INCIDENCE OF EARNINGS CAPACITY POVERTY			
Individuals	5.8%	6.9%	+20%
Children less than 6	11.3	14.5	+29
INCIDENCE OF OFFICIAL POVERTY			
Individuals	10.2	11.9	+17
Children less than 6	15.4	20.8	+35

Source: Robert Haveman and Larry Buron, "Escaping Poverty through Work: The Problem of Low Earnings Capacity in the United States, 1973–88," *Review of Income and Wealth* (forthcoming).

by self-employed people or farm owners) have income that fluctuates dramatically year to year; some of these families also systematically "underreport" their income. Such families are likely to be counted as poor when in fact they have high levels of education, ample opportunities, and quite adequate lifestyles. Again, the poor will seem more highly educated than they really are.

Finally, as the example of the Cartwrights shows, some people with high motivation and drive, but with few skills and low earnings capabilities, tend to be underrepresented in the official poverty measure.

As a result, many officially "nonpoor" Americans may have few skills and capabilities while many of the "poor" in a given year may actually have substantial earning power. U.S. poverty statistics may be capturing a group that in many ways fails to conform with accepted notions of what it means to be down-and-out, poor, or with few means of "making it" economically.

A More Permanent Measure: Would It Matter?

It is probably unrealistic to expect the Academy panel to recommend a new poverty definition based on a more permanent indicator of economic position—say, one that more clearly reflects the capabilities of a family to earn income and to be economically independent. Yet it would be interesting to see if the picture of poverty obtained from such an alternative would differ from the official picture. Would the composition of the poor be different? Would an assessment of America's progress against poverty change?

Some 20 years ago I (together with Irwin Garfinkel) devised a measure of the capability of a working-age family to earn income if the adults in the family were to work full-time, year-round. (This measure relies on the Current Population Survey, the data source used by the Census Bureau in making its official poverty estimate.) If a family's earnings capacity exceeds the poverty line for that type of family, it is able to work its way out of poverty, if it fully uses these capabilities. If family earnings capacity is less than the poverty line, the family is said to be "earnings capacity poor."

Among the advantages of such a measure is that it is not as transitory as annual cash income. Moreover, it sidesteps the problematic issues raised by the comparison of the Smith and Jones families and the Cartwright and Epson families—issues involving families' differing preferences regarding work, responses to work disincentives, and the receipt of public cash benefits. Finally, it rests more solidly on economic principles and is close to the ideal "full-income" concept of measuring the economic status of a family over its lifetime.

Table 1 compares the incidence of official poverty and earnings capacity poverty in working-age families in 1973 and 1988. In 1973, 5.8 percent of all Americans living in such families were earnings-capacity poor—that is, they could not earn enough to escape poverty, even if the adults in the family worked full-time. By 1988, that figure had increased 20 percent, to 6.9 percent. For small children the incidence rate was much higher—11.3 percent in 1973, 14.5 percent in 1988—as was the trend increase: 29 percent.

The official poverty rate for all individuals was al-

most double the earnings capacity poverty rate, but it rose a bit more slowly—17 percent. The official poverty rate for small children grew about twice as fast as that for all individuals; in addition, it grew even faster than the earnings capacity rate for children in working-age families.

Two somewhat different pictures of the nation's efforts to reduce poverty over this period emerge from the two measures. In both cases, poverty rates rose. But the proportion of young children who live in families unable to work their way out of poverty grew more slowly than the proportion living in families with annual income below the poverty line.

Table 2 summarizes the incidence of official and earnings capacity poverty for a few important groups of the working-age population in 1973 and 1988. Some surprising patterns turn up.

The more vulnerable groups—minorities and female-headed families—have 1988 official poverty rates that range from 24.5 percent to 57 percent and earnings capacity poverty rates that range from 11.9 percent to 36.4 percent. Rates for the less vulnerable groups are far lower as measured either way.

But while official poverty rates for the more vulnerable groups show little if any improvement from 1973 to 1988, the earnings capacity poverty measure shows significant progress for each of these groups. Their earnings capacity poverty measure *fell* by from 13 percent to nearly 40 percent, showing that their ability to earn enough to escape poverty rose substantially.

Another surprise is that the less vulnerable groups experienced small increases in official poverty but large increases in earnings capacity poverty rates. For these groups, generally thought to be immune from economic hardship, the incidence of earnings capacity poverty increased by from 20 percent to 92 percent.

In sum, since the early 1970s, the bad news is that groups that are most economically secure—whites, intact families, and families headed by people with postsecondary schooling—have seen their earnings capacity poverty rate increase rapidly. The good news is the large fall in the earnings capacity poverty rates of the nation's most vulnerable groups.

These patterns are consistent with developments and trends reported elsewhere. To begin with, the period from 1973 to 1988 witnessed a decline in average real earnings, reflected in the increase in official poverty. The earnings decline was the greatest for the most vulnerable groups—those with little education and few skills—who experienced both increasing joblessness and underemployment. But public benefits afforded them some "safety net" relief. On balance, their official poverty rates changed little, even though their earnings capacities rose, and their earnings capacity poverty rates fell substantially.

At the other end of the distribution, the less vulnerable families sought to counter the wage rate decline by working more hours and adding second workers. They were only partially successful, as their official poverty rates did creep up. However, because of their added work, their official poverty rates rose over the period far less than their rates of earnings capacity poverty.

The large decline in earnings capacity poverty rates for low-education, minority, and single-parent families would have been better news, of course, if the marked increase in the capability of these groups to earn their way out of poverty had been reflected in an equivalent fall in their official poverty rates. Why has the na-

Table 2. How Different Groups Are Faring

	INCIDENCE OF OFFICIAL POVERTY		INCIDENCE OF EARNINGS CAPACITY POVERTY	
	1988	PERCENT CHANGE 1973-88	1988	PERCENT CHANGE 1973-88
MORE VULNERABLE GROUPS				
Blacks	29.1%	-5%	18.5%	-13%
Hispanics	24.5	+13	11.9	-27
Female heads	33.5	-9	22.2	-26
Black female heads with children	57.0	-2	36.4	-39
LESS VULNERABLE GROUPS				
Whites	7.3	+12	4.4	+47
Intact families	8.1	+6	2.5	+20
Families headed by persons with post- secondary education	5.7	+16	2.4	+92

Source: same as Table 1.

tion not been able to realize this increase in productive capabilities? One possible explanation is that the economy failed to generate opportunities for these groups to make full use of their earnings capabilities. Another is that they chose not to use their earnings capacities more fully. On the assumption that the first explanation is the real one, economic growth, especially growth not driven by demand for highly skilled labor, could yield substantial economic gains for these more vulnerable groups.

Taking Poverty's Measure

Clearly, one's assessment of who is poor, of which groups have the highest poverty rates, and of the nation's progress against poverty depends heavily on the measure of economic position that one uses.

The task of developing a reliable indicator, or, alternatively, a series of indicators, of family economic well-being is a daunting one. Decisions on fundamental measurement issues will play a crucial role in determining the nation's collective view of how bad things are, on whom policies should be targeted, and whether or not things are moving in the right direction.

Whatever decisions the National Academy of Sciences panel makes, it will be criticized by many, applauded by few. But the panel also has the mandate, and hence a great opportunity, to change an important element of how we as a nation view ourselves. The definition of poverty, or perhaps the family of definitions, that is officially adopted will be a crucial statistical indicator of national performance. Like the unemployment rate, the poverty measure embodies a national goal. The Academy panel has the chance to influence heavily where the country puts its mouth on this matter, and, implicitly, where it should put its money. ■

*William G. Bowen and
David W. Breneman*



Student Aid

*Price Discount or
Educational Investment?*

In his recent decision finding the Massachusetts Institute of Technology guilty of price-fixing for joining with the Ivy League universities in an agreement to award financial aid solely on the basis of need, Judge Louis C. Bechtle accepts the Justice Department's description of student aid as a "discount" from tuition. In the case of MIT, that was a serious error. While student aid sometimes functions as a price discount, at MIT it functions very differently—as an "educational investment."

This is far from a semantic quibble. The answer to the question of how student aid should be viewed is (as is true of most interesting questions): "it all depends." Much confusion has been caused by thinking of the student aid that colleges provide as either always a price discount or always an educational investment. In fact, it can be either—or both—depending on the ability of the college in question to attract enough students to fill its entering class without offering any price discounts (if it were to choose to do so). It is instructive to consider polar cases.

Filling Desks or Encouraging Diversity?

At the non-MIT end of the spectrum are hard-pressed colleges that struggle to enroll enough students to meet their essential financial obligations. While some students who seek to enroll at these colleges will be willing to pay full tuition, there are not enough of them, of sufficient academic quality, to fill the entering class. Others will come only if offered a price discount in the form of a scholarship. So long as the "net revenue" contributed by this latter group of students (defined as the tuition they pay less the financial aid provided by the institution) exceeds the marginal cost of enrolling them, it is to the financial advantage of such colleges to provide price discounts in the form of scholarships.

The viability of this strategy depends on both the shape of the college's cost curve and the size of the discount, relative to tuition, needed to attract additional students. Colleges have substantial fixed costs and choose numerical enrollment targets consistent with reasonably full use of their physical plant and faculty resources; within some range on either side of the enrollment target, the incremental cost of enrolling an additional student is very low. Of course, discounts can be so large that the resulting net revenue falls below marginal cost. This is an important reason why colleges in these situations cannot be expected to provide "full scholarships" from the general funds of the institution; they are much more likely to provide many partial scholarships. Providing student aid discounts to increase net revenue is analogous to the practice of merchants in many fields—and, for that matter, to that of for-profit educational institutions.

At the other (MIT) end of the spectrum are highly selective colleges that could, if they chose to, meet their enrollment targets without offering any institutionally provided financial aid. Their applicant pools contain more than enough candidates who are qualified and willing to pay full tuition to fill all available places. Notwithstanding the understandable public

perception of tuition levels as very high, institutions such as MIT could even charge a higher rate of tuition than they do. In point of fact, however, these colleges keep their tuition charges below the market-clearing level (thus conferring benefits on the student body at large) and also provide financial aid from their own resources—even though it is not to their financial advantage to do so. Why? To achieve what they perceive to be their educational objectives.

In sharp contrast to the first set of cases, student aid is not given to affect the size of the entering class, which would be the same whether or not aid was provided; rather, it is provided to affect the composition of the class. For MIT and similarly situated institutions, student aid enables the college to attract qualified students who could not afford to come otherwise, including students who will contribute to the diversity of the student population and, ultimately, to the needs of the nation for more well-educated students from racial minorities and disadvantaged backgrounds. Decisions to spend some of the college's own resources in this way are analogous to decisions to increase spending on the library, on faculty positions, on scientific equipment, or on any number of other worthwhile activities. For institutions at this end of the spectrum, student aid outlays are discretionary and therefore represent educational investments.

Of course, there are strong internal and external pressures to provide student aid, and therefore one might argue that the true degree of discretion is limited. But that is true of every major category of expenditure, such as library acquisitions. In all such cases, discretion exists—on the margin, and certainly in times of financial adversity, as much recent experience demonstrates. And the key distinction remains: in MIT-like situations, the pressures to award student aid do not stem primarily from financial considerations related to the overall number of students who will be enrolled (indeed, the short-term financial effects will be negative); rather, they stem from a sense of what constitutes the educational objectives—even the educational obligations—of the institution.

How to Tell the Difference

A simple (conceptually at least) test allows us to tell whether student aid is a price discount or an educational investment. The key question is: does providing student aid increase or decrease the net resources available to the college to spend on other purposes?

When student aid functions as a price discount, because it is needed to enroll enough students to achieve a financial objective, it increases the net resources available for other purposes by providing some incremental tuition revenue above marginal costs. Here we assume that the enrollment target would not have been met in the absence of institutionally provided student aid.

On the other hand, when the college could meet its enrollment target without providing student aid, "gross" tuition revenue is a fixed amount, and the aid provided by the college represents a discretionary educational investment that has been chosen over other claims on the revenues of the institution. Here student

William G. Bowen, formerly president of Princeton University, is president of the Andrew W. Mellon Foundation. David W. Breneman, formerly president of Kalamazoo College, is a visiting professor in the Graduate School of Education at Harvard University. Breneman is completing a study of liberal arts colleges that will provide empirical findings related to the propositions developed in this article. Bowen testified for MIT in the current antitrust case. The authors thank William J. Baumol and Nicholas Katzenbach for helpful suggestions.

Trustbusting, 1990s-Style

In 1989 the Antitrust Division of the U.S. Department of Justice began an investigation into the activities of some 60 colleges and universities. The investigation touched on a number of practices, including coordination of financial aid practices. The focus of the investigation eventually narrowed to the eight Ivy League universities and the Massachusetts Institute of Technology.

On May 22, 1991, the Justice Department filed a complaint against the nine schools in the U.S. District Court for the Eastern District of Pennsylvania, challenging, under the Sherman Antitrust Act, certain longstanding financial aid practices, generally known as “Overlap,” in which the schools engaged. Simultaneously, the Justice Department filed a consent judgment signed by the eight Ivy League schools, but not by MIT, in which the schools agreed to cease the challenged activities, and to satisfy reporting, inspection, and compliance requirements, without admitting to liability. MIT alone continued to defend the challenged conduct in a trial on the merits that took place last summer.

The cornerstone of Overlap was an agreement by the schools not to award aid beyond a student’s demonstrated need (that is, no “merit aid”). The schools also attempted to agree on appropriate approaches for determining a given student’s need and to resolve differential need assessments on a case-by-case basis. The schools claim that need-based aid is necessary to maintain their unique policy of admitting students without regard to their ability to pay and funding all of the need of students who are admitted. Such “need-blind” admissions policies are rare and have become increasingly threatened as budget constraints have increased pressure on financial aid resources.

A central issue presented by the case is whether the Sherman Antitrust Act, enacted in 1890 to regulate behavior in the commercial marketplace, applies to the financial aid practices of nonprofit educational institutions.

In arguing that it should not, the schools have pointed out that almost all colleges and universities are qualified as charitable institutions under the Internal Revenue Code. As such they are exempted from federal taxes, and charitable donors to the schools are allowed to deduct donations from their federal income taxes.

The Justice Department’s position is that the Sherman Act applies to the schools’ Overlap agreement, which violates the act by virtue of the fact that some students—those who would have received no-need aid in the absence of the agreement—paid more for a college education than they would have in the absence of Overlap. Last September the District Court ruled in favor of the Justice Department. The appeal in the case is currently pending.

aid is a source of budgetary strain, which is why some colleges (Columbia University is a recent example) have felt compelled to cut back on financial aid when faced with deficits.

From a budgetary perspective, the proper treatment of student aid also differs in the two situations. When student aid functions as a price discount, it should not be shown as an outlay on the expenditure side of the budget of the college (as it often is). Rather, it should be treated as a deduction from gross tuition revenue and in that way taken into account in calculating net tuition revenue on the income side of the ledger. After all, the college could not have earned the full amount of gross tuition revenue without the student aid discounts. In contrast, when total enrollment is unaffected by student aid, gross tuition revenue will be the same regardless of student aid outlays, and all of it should be regarded as income. Here, student aid is appropriately treated as an expenditure—along with the other types of spending with which it competes for resources.

Ironically, “full-ride athletic scholarships,” including those provided by schools that are highly selective, also need to be understood as price discounts intended to increase revenue—only here it is mainly TV revenue generated by highly publicized teams that makes it “profitable” to provide these athletic scholarships, not increased enrollment. If it were not for NCAA rules which limit the amount of financial aid that can be provided, outstanding athletes would be able to command even larger scholarships than they do now, with no attention paid to financial need.

Of course, many colleges and universities occupy intermediate positions along what is a continuum. Consider, for example, the circumstances of a strong liberal arts college that does not, however, have the drawing power of an Oberlin or a Swarthmore. This liberal arts college may not be able to fill all its places without some use of student aid as a price discount, but it may spend considerably more on student aid than it would need to spend if it were concerned only with meeting an enrollment target. Many colleges invest some of their limited institutional resources in student aid to achieve a stronger and more diverse student body than they could attract otherwise. They are able to exercise *some* discretion, and the amount that they choose to invest in student aid will reflect institutional priorities. In mixed cases of this kind, student aid functions partly as price discount and partly as an educational investment. Real-world situations are still more complex in that investing in student aid to increase diversity and to attract some absolutely outstanding students who might otherwise go elsewhere can in turn affect total enrollment by increasing the appeal of the college to more full-tuition-paying students; and it can also increase revenues in the long run by increasing contributed income.

It should be emphasized that a college’s place along this continuum depends on its academic reputation and financial resources. While institutions surely vary in the priorities they assign to making educational investments in student aid, almost all would *like* to make such investments if they could. Thus, we are not talk-

ing here about differences in educational philosophies or about purity of intentions, but rather about harsh realities: the degree to which a particular institution can afford to make a genuine choice concerning its investment in student aid.

Making Policy Inside the Academy—and Out

Being clear about the function of student aid in different contexts is important both for wise decisionmaking within educational institutions and for broader issues of public policy. Most educational decisionmakers naturally *want* to think of student aid outlays as educational investments, but this tendency can lead to serious errors. For instance, student aid may be “capped” at an artificially low level (say, 30 percent of gross tuition revenues) because the college doesn’t believe that it can “afford” to spend more on student aid—when, in point of fact, offering some additional aid (discounts) might add to net revenues by increasing enrollment. When student aid is a discount, the focus should be on the comparison of marginal changes in net revenues and in institutional costs, not on the absolute amount of aid. In highly selective institutions, on the other hand, it is correct to think of student aid as one of many competing claims on scarce resources, and some limit may have to be placed on the amount that can be spent for this purpose if other educational goals are also to be achieved.

From the standpoint of public policy, it is important to note, first, that the very situations in which one might be most concerned about “restraints on trade” (where student aid functions as a pure price discount) are those in which agreements to follow a common approach to providing financial aid are highly unlikely. Colleges that need to use discounts to meet enrollment targets would be ill-advised to constrain their ability to compete for students by agreeing with other schools on some formulaic basis for awarding scholarships. These colleges cannot afford to collaborate, and there would seem little reason to worry about any inappropriate spread of collaborative agreements to base student aid solely on need.

At the other extreme, colleges that can fill their classes without offering discounts and that (properly) view student aid as an educational investment will have a quite different perspective. For them, student aid is a discretionary outlay, and their objective will be to make the most effective possible use of the scarce institutional funds that they have chosen to devote to this purpose. This can lead, as in the MIT case, to an agreement to award aid only on the basis of demonstrated need defined in a common way. Otherwise, scarce scholarship funds could be used “inefficiently” by being assigned to a well-to-do student who might have enrolled anyway.

One could accept the distinction between price discounts and educational investments presented here and still argue against collaborative student aid programs on the grounds that they are intended to allow participating institutions to purchase a desired “service” (for example, diversity) more cheaply than would be possible otherwise—by, in effect, making it harder for students to “shop around” for the best

possible financial aid package. If student aid funds were unlimited, this way of thinking would have more appeal than it does in real-life situations in which the pressures on outlays of all kinds, including student aid outlays, are enormous. The practical consequences of making it more difficult for educational institutions to concentrate limited resources on students with demonstrated need are likely to include less financial aid for needy students—and perhaps for all students, since the general appeal of student aid, as a budgetary outlay, is likely to be reduced if it no longer serves the principle of equal opportunity in a clearly cost-effective way.

We would argue that whatever cost is borne by students who have less opportunity to “sell themselves to the highest bidder” is more than compensated by the benefits enjoyed by other students who have greater need for limited student aid resources. Presumably this is one reason why the government itself insists on a single, need-based standard in administering federal programs such as Pell grants. In any case, this is at bottom an issue of fairness and of social policy, as well as of efficient use of scarce institutional funds. From a public policy perspective, it is hard to see the social gain to be achieved by prohibiting trustees from making those choices that seem to them most consistent with the missions of the nonprofit institutions for which they are responsible.

MIT as “Big Steel”?

Recognizing that, for an institution such as MIT, student aid is to be understood as a discretionary educational investment by a nonprofit entity makes it much easier to see the inapplicability of the traditional argument used to demonstrate the harmful consequences of collaborative price-setting in profit-making contexts. There, collaborative behavior serves to reduce output and to raise price. In the MIT context, on the other hand, providing need-based aid defined according to a common methodology has no effect whatever on “output” (enrollment), which is determined independently. Moreover, net revenue is reduced, not increased, by providing student aid in any form. Options for “consumers” (students) are increased, since awarding a budgeted amount of aid strictly on the basis of need gives more students a chance to attend an expensive institution.

In the case of these institutions, the correct analogy is not with “Big Steel,” in the days before the Sherman and Clayton antitrust acts were passed. Rather, the apt analogy is with other collaborative efforts by these same educational institutions to use scarce resources as effectively as possible. Examples include agreements among institutions to divide responsibility for subscribing to high-priced scientific journals, to collaborate in providing expensive educational programs, and to share the costs of expensive laboratories. Like the need-based aid program followed by MIT, all these practices are agreements among potential “competitors,” but they hardly seem “antisocial.” They surely do not call for the opprobrium associated with price-fixing as understood by the framers of the antitrust laws. ■

Michael C. Dorf

Artifactions

The Battle over the National Endowment for the Arts

Michael C. Dorf, partner in the Chicago law firm of Schuyler, Roche & Zwirner,
consults nationally on arts policy and advocacy issues.

As the Republicans stumped New Hampshire last spring, candidate Patrick Buchanan lashed out at the National Endowment for the Arts for supporting a counter-culture aimed at eradicating Christian values. A war, he charged, was being waged “for the soul of America,” and in that war, the Bush administration had become a “conscientious objector.” The solution, as Buchanan saw it, was to “close, padlock, and fumigate” the NEA. In response, President Bush fired NEA Chairman John Frohnmayer and turned the agency over to those who, while “saving” it, may be doing it more damage than a padlock ever could.

The NEA had drawn Buchanan’s wrath for, among other things, awarding a grant to the Washington, D.C., Corcoran Gallery of Art for an exhibit that included a series of photographs by Robert Mapplethorpe depicting sadomasochistic and homoerotic activities. Accordingly, in one of her first acts as acting chairwoman of the NEA after succeeding Frohnmayer last May, Anne-Imelda Radice vetoed grants for two sexually explicit art exhibitions requested by the Massachusetts Institute of Technology and Virginia Commonwealth University. Both had been recommended for funding by NEA expert advisory panels and the 26-member National Council on the Arts. Radice stated in interviews with the *Washington Post* and the *New York Times* that she took the actions “to preserve the arts endowment; that’s my goal. If the agency survives, people will say, ‘I didn’t agree with her, but thank God the endowment’s still here.’”

Radice’s actions represent a radical shift in NEA policy, which has been that arts grants are to be judged by artists and art historians, not government officials. If, as Radice states, the agency’s goal has become its own survival through the suppression of controversy and experiment, the time has come—and the election of Bill Clinton presents the obvious opportunity—to reevaluate the NEA’s philosophy, purpose, and perhaps even its existence.

The National Endowment for the Arts was established by Congress in 1965, along with its companion agency, the National Endowment for the Humanities, with a declaration that “while no government can call a great artist or scholar into existence,” it can and should help sustain “a climate encouraging freedom of thought, imagination, and inquiry” and also provide material support encouraging “the release of this creative talent.” Indeed, the federal government has a long history of support for cultural programs, including the establishment of the Smithsonian Institution in 1846, the National Conservatory of Music in 1891, and the National Fine Arts Commission in 1897. With the exception, however, of the Works Progress Administration arts employment projects of the New Deal, the NEA was the first agency to grant money directly to private individuals and institutions to create and present works of art without governmental commissioning or control.

Since 1966, the NEA has awarded more than 95,000 grants, spending more than \$2.6 billion in federal funds, which have been more than equally

matched by nonfederal sources. Grants are initially recommended by advisory panels in 17 program areas such as music, dance, architecture, and museums. They are then reviewed by the National Council on the Arts, whose members are appointed by the president with the advice and consent of the Senate. Final decisions are made by the NEA chairman, also a presidential appointee. The chairman cannot approve or disapprove any grant application before receiving the council's recommendation on it. Until the past few years, the chairman rarely overturned a council recommendation.

When Is an Endowment Not an Endowment?

Since its inception, the NEA has never truly been an "endowment," in any commonly known sense. It has no permanent funds and, as any other federal agency, receives appropriations from Congress covering expenses for the current fiscal year only. Carrying over unspent funds from year to year is prohibited, and all grant awards, including those meant to be multiyear in nature, carry a disclaimer that they are subject to the availability of appropriations. By contrast, the Smithsonian Institution and the National Gallery of Art, both established by private gift and both aggressively engaged in private fund raising, have been accorded the right to maintain nonfederal "trust funds." These funds have often been used to pay for programs and acquisitions not authorized by Congress and for hiring key staff members to bypass Civil Service regulations on selection and salary.

Although the NEA is permitted to accept private gifts, it has made no effort to use that power to give itself the leeway to support controversial artistic activities. Instead, the NEA channeled the obligation to secure private funds to the award recipients through its matching grant program. Nevertheless, from the beginning, the NEA encouraged cutting-edge programming and often became the funder of last resort for projects that could not initially get money from private foundations. As Roger Stevens, the NEA's first chairman, replied when asked how the endowment was different from such foundations, "We do more daring things than they can do." The agency frequently excused the small size of many of its grant awards by describing them as "Good Housekeeping Seals" that assured private foundations and corporate donors that it was safe to fund a project and match the federal grant.

The NEA's first years were marked by a continuing increase in appropriations, par-



Legitimate
questions, upon
which reason-
able people
can differ, exist
concerning the
role of govern-
ment funding
of the arts.

ticularly during the Nixon administration. Funding leveled off during the Carter years. The Reagan administration initially proposed eliminating all funding, but backed off in the face of massive congressional and public opposition. Over the years a number of grants drew controversial attention. Among the most publicized were a \$5,000 award to Erica Jong in 1973, used in part to support the writing of *Fear of Flying*, and a 1977 grant of \$6,025 to LeAnne Wilchusky to throw crepe paper streamers out of an airplane as a “sculpture in space” that “called attention to the higher spirit of mankind.”

Although these and several other incidents raised congressional hackles, there were few lasting consequences. A congressional hearing investigating an NEA grant for a poem by Aram Saroyan, whose title and full text were “Lighgt,” for example, was headed off when Congressman Clarence “Doc” Long (D-Md.) commented, “Mr. Chairman, I don’t pretend to know too much about poems, but this is the first one I’ve been able to memorize.” Indeed, a prime reason for the NEA’s survival has been its strong congressional champions, foremost being Representative Sidney R. Yates (D-Ill.). Yates, as chairman of the House Appropriations Subcommittee on the Department of the Interior and Related Agencies, was responsible not only for the funding of the two endowments, the Smithsonian Institution, and other federal cultural programs, but also for the budgets of almost all Interior Department programs, the fossil fuel programs of the Department of Energy, and the Forest Service programs of the Department of Agriculture. The Appropriations subcommittee chairmen, known collectively in Congress as the “College of Cardinals,” wield immense influence among their colleagues. More times than is liked to be admitted, the NEA has benefited from timely assistance to a fish hatchery in North Dakota, a coal mine in Pennsylvania or West Virginia, or a timber cut in Washington state. When a Senate amendment restricting the NEA was removed in exchange for an increase in federal land grazing rights, the phrase “corn for porn” became the instant characterization.

Politics of the Arts

The second reason for the NEA’s survival of occasional congressional displeasure was the political skill of its leaders, who recognized that the arts, with their power to enrich or enrage, were political and needed to be treated as such, but that they also were nonpartisan. Roger Stevens, the first chairman, had been an assistant to President Lyndon Johnson. Nancy Hanks, his successor, was a protégée of Governor and Vice President Nelson Rockefeller. Livingston L. Biddle, Jr., had been an aide to Senator Claiborne Pell and had been instrumental in drafting the NEA’s organic legislation. Finally, Frank Hodsoll had been a close associate of James Baker during the 1980 presidential campaign. Each of these chairmen understood the nature of coalition politics and how, for example, a well-publicized and wholly meritorious award to a relatively “safe” recipient such as the Utah Symphony (whose director, the witty and talented Maurice

Abravanal, was a favorite of members of Congress at hearings, and whose senator, Orrin Hatch, was a conservative leader) could be used to assuage the misgivings caused by a second, and equally meritorious, grant to a more controversial New York performance artist. Even Hodsoll, who represented an administration bent on abolishing the NEA, found ways to convince his superiors of the worth of the agency and the impracticality of battling the forces that Yates and his allies had amassed.

This talent for working the system has not been universally considered an asset for the agency. Some critics have charged that the politicization of the NEA, particularly during the Carter administration, led to the current round of troubles. Most of those charges centered on the debate between “populism and elitism” or, more pejoratively, “access versus quality,” as if the terms were mutually exclusive. The criticism emerged in particular from the creation of new program areas such as Expansion Arts, Folk Arts, and Advancement Grants, geared toward smaller and younger arts groups, including many minority, ethnic, and more experimental artists and organizations ineligible for NEA grants under existing categories. The debate, however, which has continued over the years, was never really about the artistic merit of the new grants. Rather, as Michael Mooney stated in *The Ministry of Culture*, the real argument was “over the division of spoils. As long as the ‘eastern seaboard illuminati’ continued to get about the same monies the Nixon administration had dealt out to Lincoln Center, the Metropolitan Opera, and the Boston Symphony, the oligarchs of the East had few objections to new ‘populist’ fundings for ‘folk arts.’”

Under Heavy Fire

John Frohnmayer, an Oregon lawyer who had been a respected chairman of the Oregon Arts Council, never got the hang of the system. As the *New York Times* described it, “Mr. Frohnmayer, over two and a half years of shifting his position, managed to antagonize artists, arts administrators, and those who took a permissive approach to government support of the arts.” Meanwhile, conservatives, who blamed him for the Mapplethorpe grant even though it had been set in motion before he took office and who didn’t trust his subsequent vetoes of award recommendations, called for his firing. In only a few months the chairman had secured the wrath of all sides.

Frohnmayer’s most disastrous decision came in response to a congressional mandate attached to the fiscal year 1990 NEA appropriations bill. At the instigation of the American Family Association and Senator Jesse Helms (R-N.C.), several attempts, backed by massive direct mail campaigns, were made to restrict the criteria used to judge grant applications, including shopping lists of proscribed topics covering everything from flag “disrespect” to blasphemy to offensiveness to inappropriateness. When it appeared clear that the mood of Congress would require some type of vote for restrictive language, Yates agreed to add a provision to the appropriations bill that essentially tracked the U.S. Supreme Court’s 1973 obscenity ruling in *Miller*

v. California. The language, which applied to both the NEA and the National Endowment for the Humanities, prohibited projects that “may be considered obscene, including but not limited to, depictions of sado-masochism, homoeroticism, sexual exploitation of children, or individuals engaged in sex acts which, when taken as a whole, do not have serious literary, artistic, political, or scientific value.”

Lynne Cheney, chairwoman of the National Endowment for the Humanities, recognized that the prohibition of obscenity was merely a restatement of existing law and a way to let members of Congress vote for decency. She ignored it, and, although the NEH was in many ways as controversial as its companion agency, there was little fuss. Frohnmayer, however, required grant applicants to swear in advance that no NEA funds would be used “to promote, disseminate, or produce materials which . . . may be considered obscene.” The response was predictable. The NEA returned to the national spotlight as one arts organization after another lined up to denounce publicly the agency’s “loyalty oath,” in some cases turning back money that had already been awarded. Increasingly, artists who on merit alone had no chance of getting a grant, submitted deliberately outrageous projects, calling press conferences during the NEA to turn them down. Frohnmayer’s subsequent proposal, “obscenity boards” for judging a project’s compliance with the grantee’s sworn oath, lost him all remaining credibility with the arts community. Opponents of the agency, incensed by the publicity surrounding the artists, escalated their own attacks. The Bush administration, watching as the endowment lurched from one embarrassment to another, hesitated to fire Frohnmayer. Finally, the Buchanan attack during the New Hampshire primary moved the president to act.

The clamor had so overwhelmed the purposes of the NEA that, in a much noted telecast of *This Week with David Brinkley*, Brinkley, along with George Will, Cokie Roberts, and Sam Donaldson, a wide sample of Washington conventional wisdom, all agreed it was time for the NEA to be put out of its misery and out of business.

Instead, the new “safe” NEA has been born, committed to the support of inoffensive programming. The premise of the incubator for “more daring things” than the private sector will risk appears ended. In its place is another money tree for mainstream works of artists and organizations. While this mission may keep the agency going for the short term, it leaves the NEA without any root system to keep it standing when the next controversy blows over it.

Congressman Yates has noted that “The glory of the endowment was that you didn’t have the Government judging applicants; they were judged by their fellow artists. If [Radice] changes that . . . it will be difficult to get the best people to serve on the panels.” As of this writing, several advisory panels have indeed resigned *en masse*. Stephen Sondheim turned down the 1992 National Medal of Arts award administered by NEA, stating that to accept an award from the endowment would “be an act of the utmost hypocrisy.” Next

Wallace Stegner turned down the medal, stating that “support is meaningless, even harmful, if it restricts the imaginative freedom of those to whom it is given.” And a new series of grantees are turning back awards.

It’s Time to Rethink the NEA

The chance to restructure the NEA will come in 1993 as Congress takes up the agency’s reauthorization and President Clinton appoints a new NEA chairman. (The huge congressional turnover in the wake of the November 3 elections will also provide a new tone to the debates.) Among the recommendations that should be considered is creating a true endowment fund, either based on private donations or a one-time federal grant, to be used, as the Smithsonian Trust Fund is, to provide support that is not directly dependent on appropriations. The statutory role of the National Council on the Arts should also be strengthened, providing for a supermajority override of vetoes by the chairman of recommended grants. The issue of content restrictions on arts grants also needs to be put to rest, for court challenges to “indecent” and “appropriateness” standards will not prevent the uncertainty and chilling effect that these vague and ambiguous restrictions will have on the artist attempting to comply with, or the agency trying to administer, such restrictions.

But what ultimately is needed is a reconsideration—nonpartisan, to the extent possible—of the fundamental question of whether the government should nurture the arts in America. Certainly the arts have no *right* to governmental support. At the same time, historically, the enrichment of mind and spirit associated with the arts has been a relevant and necessary part of the general welfare of the citizens of the world’s great civilizations. Before we undertake to restructure the NEA, we should be sure what role we want the federal government to play in supporting the arts in this country.

Conducting a serious discussion of the matter will not be easy in the current atmosphere. Despite Acting Chairwoman Radice’s efforts to placate Senator Helms and his followers, the NEA’s value as a bogeyman for right-wing fundraisers has grown to such levels that there is little motivation for them to end the turmoil. And instead of attempting to turn down the heat on this debate, many *supporters* of the NEA have seized on similar tactics, accepting the Helms premise that arts funding is a question of morality rather than philosophy. This is a serious mistake. Legitimate questions, upon which reasonable people can differ, exist concerning the role of government funding of the arts. But when viewpoints are transformed, by either side, into questions of morality, there can be no serious debate nor any opportunity for compromise.

It is the nature of art to stimulate, to exhilarate, to exasperate, and sometimes to offend—sometimes all at the same time. The great strength of the National Endowment for the Arts has been the underlying premise that not only were Americans not fearful of the clash of ideas and emotions through the arts, but that we welcomed and encouraged such ferment.

The arts cannot be saved by making them “safe.” ■

But when viewpoints are transformed into questions of morality, there can be no serious debate nor any opportunity for compromise.

To all appearances, America's once-vaunted manufacturing sector is in trouble. The picture painted by Donald L. Bartlett and James B. Steele in *America: What Went Wrong?* is stark: U.S. factory workers are vanishing, U.S. manufacturing companies are shifting operations overseas, and foreigners are taking over U.S. companies. Growth in both workers' wages and company profits has faltered badly in the United States over the past 20 years. Auto workers and auto companies have lost thousands of jobs and billions in profits. Huge losses have also buffeted the apparel, consumer electronics, and steel industries.

Indisputably, many American workers and manufacturing companies have had rough going over the past two decades. But U.S. manufacturing as a whole is showing clear strength. And some of the things that may seem most worrisome—job losses, plant closings—are actually signs of health.

A successful manufacturing sector will have high and growing productivity. It will also, as a corollary, experience unsettling turnover as less productive plants close down. When manufacturing is, in addition, participating actively in international trade, production and jobs will move around, and many jobs will be lost. That is what is happening in U.S. manufacturing today.

MARTIN
N. BAILY

Manufacturing Trade

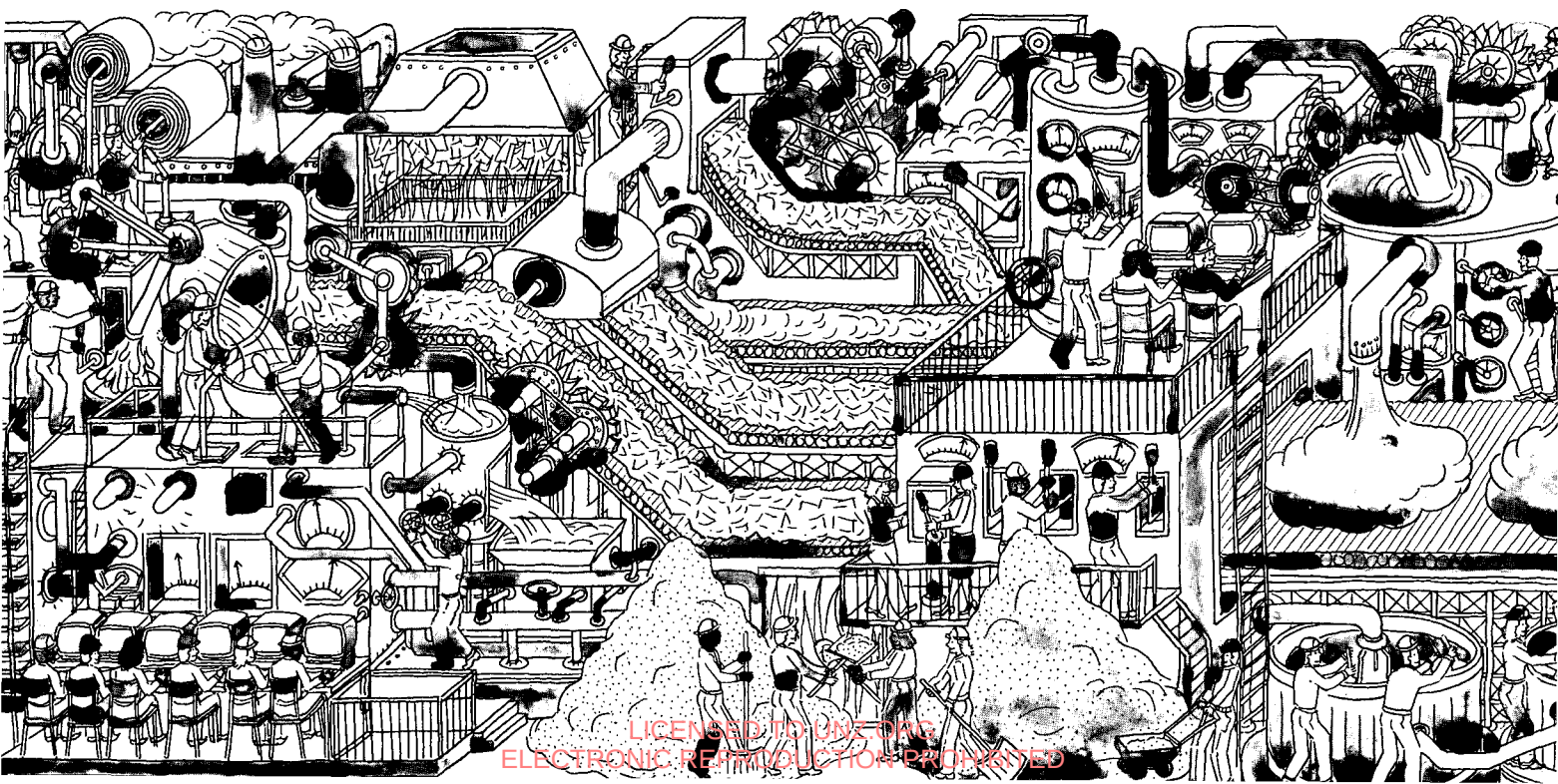
For the past 10 years U.S. manufacturing productivity has grown briskly. Even so, the manufactured goods trade balance has been heavily in deficit—roughly \$125 billion in 1987, down to \$47 billion in 1991.

During 1991 the United States ran trade surpluses of from \$5 billion to \$10 billion each with Canada, the European Community, other Western European nations, Mexico, and the countries of the Middle East. Given the value of the dollar in 1991, the United States was competing effectively with Europe overall, although its surplus with the EC conceals a substantial deficit with Germany. The trouble lay in the deficit in trade with Japan (roughly \$60 billion) and the newly industrialized countries of Southeast Asia (about \$20 billion).

U.S. manufacturing performance in trade has varied enormously by industry over the past 10 years, with strong surpluses in capital goods, commercial aircraft, and chemicals. Some high-tech products, such as computers and semiconductors, where one might have expected strong surpluses, actually show declining surpluses or even small deficits. The large deficits have been in apparel, other consumer goods, and automobiles (*figure 1*).

The explanation for America's manufacturing trade deficit, however, does not lie in the overall health or

MADE IN THE U.S.A.



LICENSED TO UNIVERSAL
ELECTRONIC REPRODUCTION PROHIBITED

the productivity of its manufacturing sector. Instead, the trade deficit is largely the result of a shortage of national saving. Economists have long been sounding the alarm about how the federal budget deficit reduces national saving and hence tips the trade balance into deficit. For the foreseeable future the overall trade deficit will be driven by the balance between domestic saving—the part of national income that we set aside as a nation by refraining from consumption—and domestic investment—the amount businesses buy of new equipment and offices plus the amount that households put into new housing. As Paul Krugman has pointed out, we could solve the overall trade deficit problem by raising saving or reducing domestic investment, preferably the former. But since no one seems willing to do either, the trade deficit will continue. (This iron law also explains why trade policies that are often suggested as a way to reduce the trade deficit would not work. For example, if a new quota policy were to cut the import of autos, then other imports would simply rise to take their place, or U.S. exports would fall, or both would happen.)

Manufacturing Competitiveness

Germany and Japan, by contrast, have been running trade surpluses for many years, not because their manufacturing sectors are more productive than ours, but

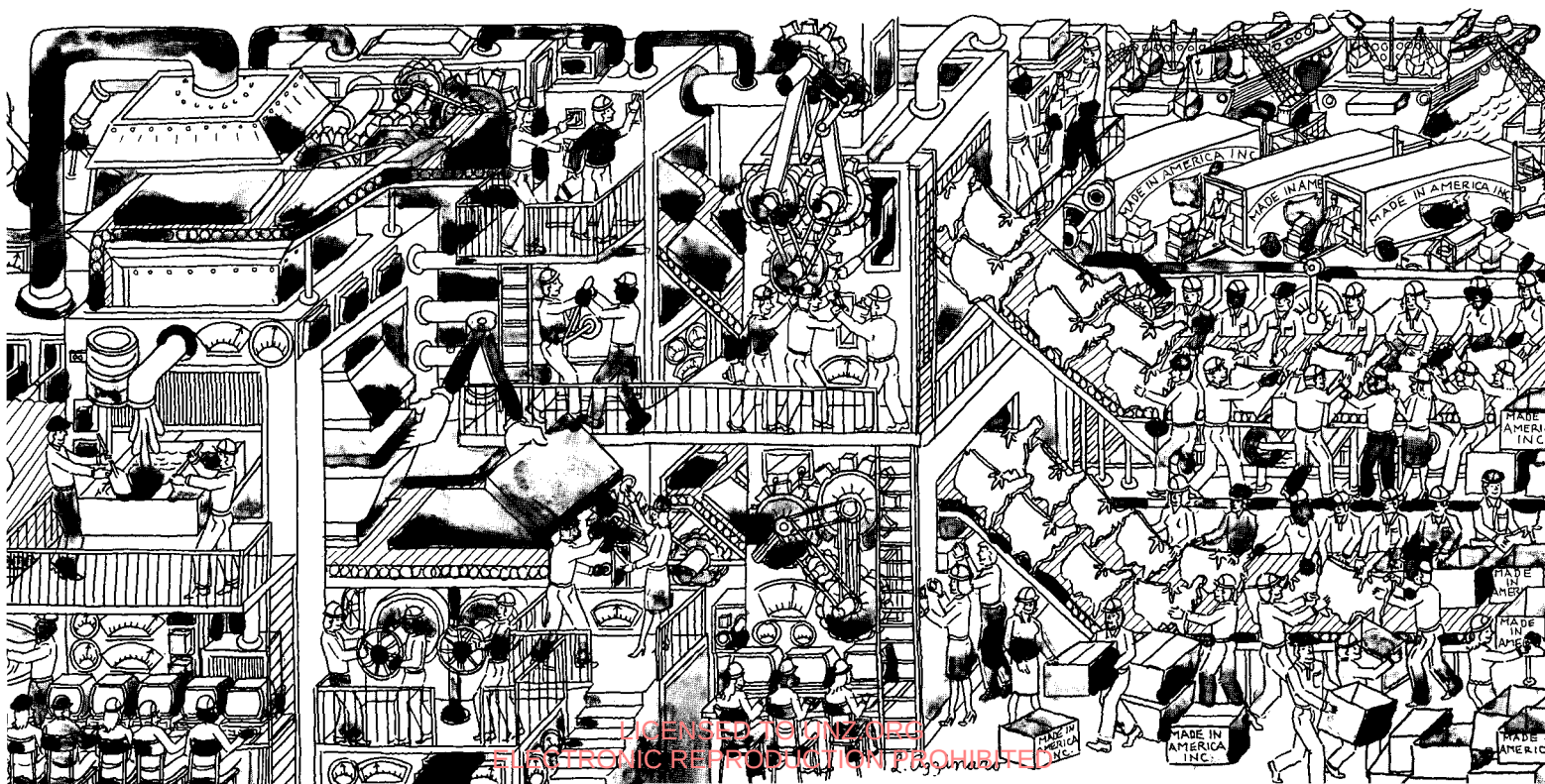
because their rates of national saving are high relative to their domestic investment opportunities. Nevertheless, if productivity is not the determinant of the trade balance, it is certainly one important determinant of trade competitiveness. It is also one clear measure of competitiveness in its own right. And the U.S. manufacturing sector has shown strong productivity growth in the 1980s as it has retained a surprisingly large lead in productivity over Germany and Japan (figure 2).

Even though the trade deficit is attributable to the imbalance in the macroeconomy and even though U.S. manufacturing continues to outperform its Japanese and German counterparts in productivity, there remains a concern about U.S. international competitiveness. If the value of the dollar were still high in foreign exchange markets, then we would say that U.S. manufacturing is certainly competitive, but is being hamstrung by a high dollar. But the dollar is not high. Since 1988 the United States has had both a trade deficit and a low exchange rate, one that makes U.S. wages and other costs look low compared with our main competitors. In fact, to achieve balanced international trade in manufactures, the value of the dollar would have to have been roughly 10 percent lower from 1988 to 1991 than it actually was. It is a puzzle that our manufacturing industries need such an

Martin N. Baily
is an associated staff
member with the
Brookings Economic
Studies program. He is
the coauthor, with
Gary Burtless and
Robert E. Litan, of
Growth with
Equity: Economic
Policymaking
for the
Next Century
(Brookings, 1993).

PRODUCTIVITY AND COMPETITIVENESS IN AMERICAN MANUFACTURING

ILLUSTRATION BY LEW AZZINARO



assist from the exchange rate to be able to sell competitively.

There are two likely, and somewhat related, explanations. The first is that not all of our industries have a productivity advantage. The second is that we have lost our lead in technology and product quality in some areas.

Although overall U.S. productivity is much higher than Japan's, the picture varies from industry to industry. According to Bart van Ark and his colleagues at the University of Groningen, Japan has the lead in machinery and autos, while the United States has a huge lead in food processing and textiles. The difficulty is that Americans, in a fairly open economy, buy Japanese cars, whereas the Japanese do not buy the goods for which the United States has the edge. (Robert Lawrence has pointed out that Japan has low levels of manufactured imports from *all* countries, possibly because of informal trade restraints or the workings of the Japanese *keiretsu* system.) In fact, much of the U.S. trade deficit with Japan involves trade in a single industry, autos and auto parts.

Why Has the Auto Industry Been a Problem?

Of the hundreds of books and articles on U.S. competitiveness, most are about the auto industry. Difficulties with new product development, quality and reliability, and productivity are described repeatedly. U.S. auto companies have been losing money, closing plants, laying off workers, and struggling to find the funds for new product development. It is quite a change from 1982, when General Motors was one of the companies extolled by Thomas J. Peters and Robert A. Waterman in *In Search of Excellence*. What went wrong?

The answer is a combination of things: an early lack of competition, loss of a clear technology and productivity advantage, and bad luck. At the end of World War II the U.S. industry had a huge advantage over the rest of the world. One study estimates that in 1955 each U.S. employee produced 19.8 motor vehicles a year, compared with 3.9 "equivalent" vehicles in Germany. The United States also enjoyed a natural barrier to foreign competition: Americans didn't buy the types of vehicles produced in other countries. Finally, the U.S. industry had few major players, and the United Auto Workers controlled virtually the entire work force. GM's "excellent" performance was achieved in a market where competition was very limited. The industry was extremely vulnerable.

The huge size of its auto market and the affluence of its auto buyers made the United States a natural target for export-led economies like Japan and Germany once they had developed their own operations productively. They began by offering low-cost small cars that U.S. companies did not make. Then as their own capacity increased and as the price of energy shot up (the bad luck part), the whole U.S. market suddenly changed and became much more competitive. American companies were not ready for the fight. Managers could operate successfully when competition was limited but not when alternative sources of production became available. Workers had negotiated salaries that were well above those in other manufacturing industries and were resistant to changes in work practices.

Over the years, however, the U.S. auto industry has changed. Increased competition has enforced higher quality and productivity. And Japanese companies are now producing here. We can hope and expect the trade deficit in autos to decline gradually.

Important as the early lack of competition in the auto in-

dustry was, it was not the whole story. Limited competition (and high worker earnings) has not kept the commercial aircraft industry from becoming a large and growing net exporter. The key difference is that auto technology has spread widely around the world while aircraft technology, more complex and still changing rapidly, has not. (Technological change in aircraft was partially supported by the U.S. Defense Department.) The limited access to technology provides a continuing barrier for the civilian aircraft industry, at least for Boeing (McDonnell Douglas has lost market share to Europe's Airbus). Whether the workers and management of Boeing can retain their advantages in the face of increased competition from Airbus and possible entry into the industry by Japan or the newly industrializing countries of East Asia remains to be seen.

Is High-Tech Manufacturing Losing Ground?

Books on competitiveness that are not about the auto industry are mostly about high-tech industries. Japan has now surpassed the United States as a producer of dynamic random access memory chips (DRAMs), and many articles portray the threats in computers, biotech, superconductivity, and other areas. Has the United States lost its "comparative advantage" in high technology?

The effect of trade is to rearrange the pattern of production. Without trade, the kinds of products manufactured within a country depend on the pattern of domestic demand. The fraction of a nation's manufacturing industry that produces high-tech domestic goods will depend on how much those industries can sell at home. With trade there is no longer a direct match between what a country buys and what it produces. If a country has a comparative advantage in high-tech, trade will increase the production of high-tech goods that are then sold overseas in order to import low-tech goods. Or the reverse could be true if the advantage in high-tech is lost.

During the 1970s the U.S. trade surplus in high-tech manufactured goods grew—to \$26.7 billion by 1980—but it has declined since. That does not mean, however, that America no longer has a comparative advantage in high-tech.

A better indication of U.S. comparative advantage is the difference between the high-tech and the low-tech trade balances. Whereas the high-tech balance has held up reasonably well in the 1980s (dipping from \$24 billion in 1980 to \$12 billion in 1988), the trade balance in other industries has been wildly in deficit (worsening from \$13 billion in 1980 to \$125 billion in 1988). High-tech industries did have trouble competing in the mid-1980s, when the U.S. dollar was very high, but nothing like the troubles of the other manufacturing industries. Trade is still making high-tech a more important part of our manufacturing sector than it would be otherwise.

Despite its continuing comparative advantage in high-tech trade, the United States no longer has the absolute lead in high-tech products that it once had. The share of the global market for high-tech products that was supplied by U.S. producers fell from more than 40 percent in 1980 to around 35 percent in 1990. In Japan the share has risen steadily, from 18 percent to 30 percent, although in Europe the share has been falling since 1980, from 38 percent to 32 percent. Figure 3 shows that high-tech imports, most notably computer components and scientific instruments, are increasingly penetrating the U.S. market.

The United States has lost technological leadership in many products. It enjoys fewer and fewer virtual monopolies in either product or process technology. The loss of those monopolies has probably hurt U.S. manufacturing, which is no longer able to command high profits and wages from producing unique products to quite the same extent. But consumers are better off with increased choices. IBM, for example, finds it much harder to earn profits from producing computer hardware, but U.S. consumers can benefit from their access to low-cost computers produced here and overseas.

Finally, although the United States may have lost the lead in some computer components, computer hardware is becoming less and less important compared with software. The market value of IBM is down, but the market value of Microsoft has soared. And IBM is restructuring itself to concentrate less on hardware and more on software and systems development. That is not entirely new, of course. IBM's dominant market position was built on providing strong support to computer users.

The semiconductor industry provides a related example. The United States has ceded a large fraction of the DRAM market to the Japanese, but perhaps the decision made good business sense. Profits have been low in this segment of the market because of overcapacity, including new competition from Korea. But Intel is now making high returns from its unique computer chips. Just as the brain power embodied in computer software is becoming more important than the hardware itself, so too within the semiconductor industry, it is the brainpower within the chips that is important. The U.S. manufacturing and service industries retain considerable strength in the most profitable parts of the high-tech market.

Implications

U.S. manufacturing has achieved strong productivity growth in recent years and continues to outperform manufacturing in Germany and Japan. An important reason for the good performance is that U.S. companies generally face strong competition both at home and abroad.

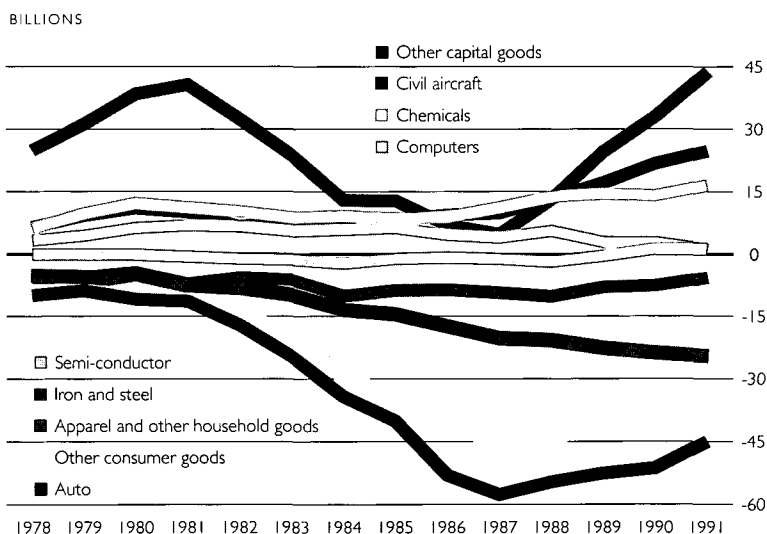
By far the biggest issue of the 1992 presidential election was the economy. As the new administration begins to address the country's economic problems, what lessons should be drawn from the analysis provided here?

First, vigorous competition, both foreign and domestic, is crucial to strong U.S. manufacturing productivity.

Second, strong competition in a rapidly changing economy inevitably means that some workers will lose their jobs. And workers in U.S. manufacturing, particularly production workers, have already suffered heavily from job losses and flat wages. To make the system fair, as well as more efficient, workers who lose their jobs must be provided with adequate temporary income support and a nationwide program of re-training to equip them with new skills.

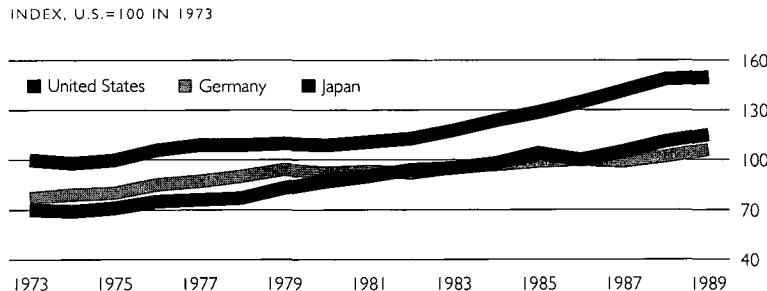
Third, the technology lead on which U.S. manufacturing has traditionally relied to compete in world markets has eroded. It is appropriate in a competitive market economy for government to provide some financial support for technology. That support need not distort the market and can help the manufacturing sector create unique new products and processes to sell here and around the world. If a serious attack can be made on the budget deficit, then support of new technology provides one way to return the economy to trade balance with a strong dollar.

Figure 1. U.S. Trade Balance in Manufactured Goods, 1978-91



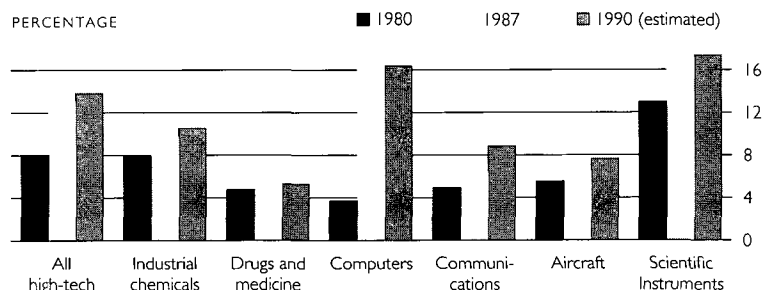
Source: U.S. Department of Commerce, Bureau of Economic Analysis.

Figure 2. Manufacturing Productivity in Germany, Japan and the United States, 1973-89



Source: U.S. Department of Commerce, Bureau of Labor Statistics; University of Groningen.

Figure 3. How Much of the U.S. High-Tech Market Is Supplied by Imports?



Source: Science and Engineering Indicators, 1991.

NAFTA as the Center of an Integration Process

THE NONTRADE ISSUES

Robert A. Pastor

The North American Free Trade Agreement was initialed by trade negotiators from the United States, Mexico, and Canada on October 7, 1992—more than two years after Mexican President Carlos Salinas de Gortari first proposed it. Salinas's idea of dismantling trade and investment barriers between the three countries was revolutionary, especially for Mexico. "In the old days," recalled Jesus Silva-Herzog, Mexico's Institutional Revolutionary Party (PRI) Minister of Finance in the mid-1980s, "we PRIistas were taught that Uncle Sam and foreign investment were the problem. Now, we are being told that they are the solutions."

Salinas, U.S. President George Bush, and Canadian Prime Minister Brian Mulroney wanted to confine the NAFTA negotiations to trade and investment alone. But the U.S. Congress viewed that agenda as too narrow and insisted on including issues related to the environment, labor standards, human rights, and democracy. This broader agenda was unorthodox for a trade negotiation, but the issues were part of a larger social, economic, and political debate within the United States and Mexico and between them. NAFTA, it is becoming increasingly clear, is actually part of a wider social and political process of integration between the United States and Mexico. In fact, NAFTA represents the first decision by the two countries to manage the process that has been binding them together since the early 1960s, when Mexicans began journeying north to the United States, legally and illegally, in very large numbers.

More than 2.5 million Mexicans have legally immigrated to the United States since 1960, and many more came illegally or traveled back and forth. In the fall of 1986 a *New York Times* poll in Mexico found that half of those interviewed had a close relative living in the United States.

U.S.-Mexican trade has also been growing. In 1980

Mexico became the third largest trading partner of the United States. The decline in the peso's value during the mid-1980s and the widening wage disparity between Mexican and U.S. labor led to a dramatic increase in the number of *maquiladoras*, plants inside the Mexican border assembling U.S.-made parts for return shipment to the United States. The increasing interconnection of the automobile industries in Canada, the United States, and Mexico is another sign of a deepening economic integration.

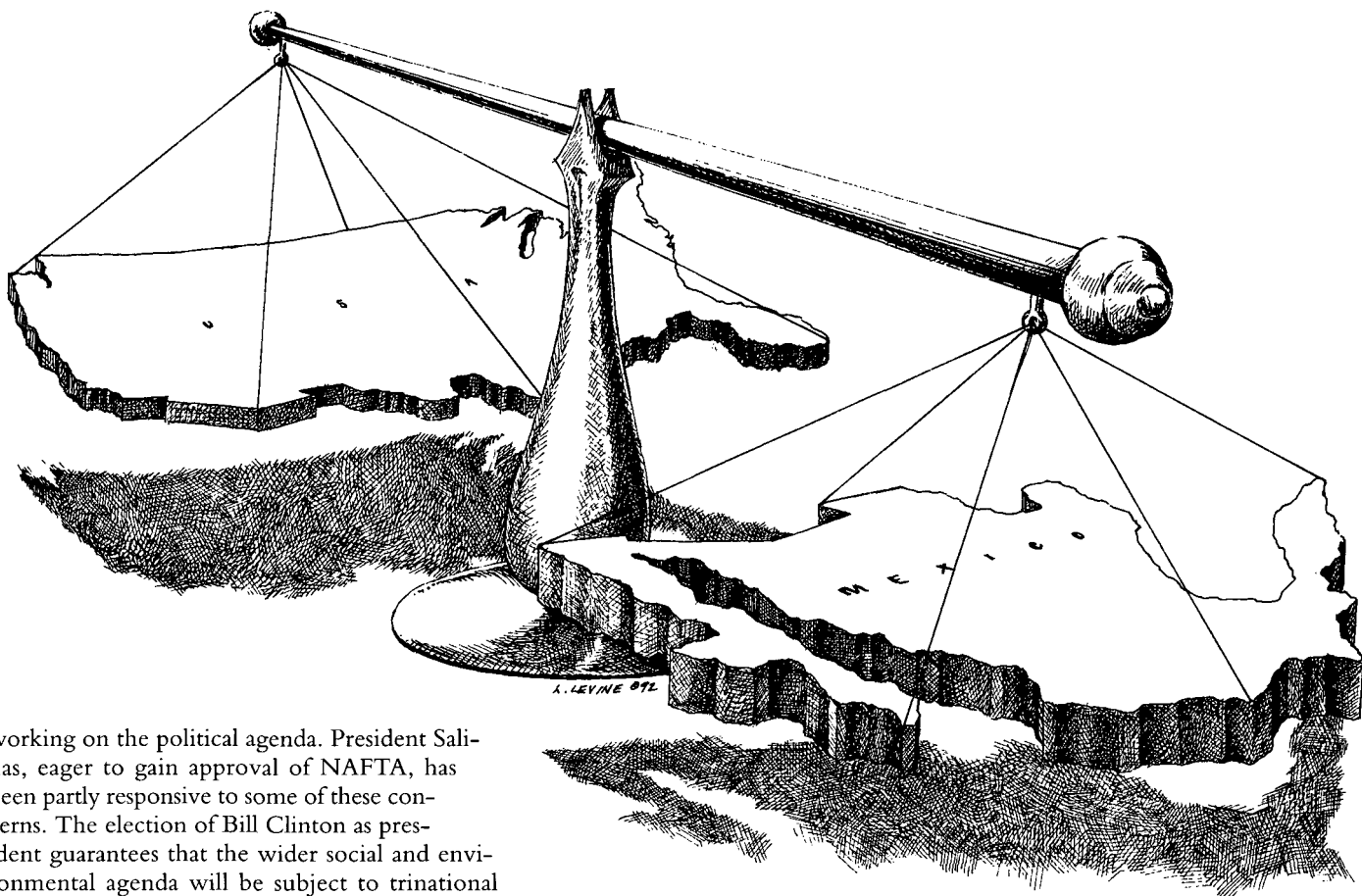
In retrospect, Salinas's proposal for a U.S.-Mexican free trade area was a political acknowledgment of the social and economic ties weaving Mexico and the United States together. But it also paved the way for more rapid change in the future.

The Substantive Debate

To all appearances, the U.S. Congress has been the principal engine behind the nontrade agenda. It has articulated an uneasiness felt by some U.S. sectors, especially workers, that NAFTA will encourage U.S. industries to relocate to Mexico. It has also expressed concern about Mexico's poor human rights record and lack of democracy, and it fears that the treaty could lower environmental standards.

But although Congress has been making most of the noise on these issues, Mexican groups too have been using the leverage provided by the congressional debate to advance their own agenda. The "Group of 100," led by former Mexican Ambassador Homero Aridjis, has been pressing the Mexican government for more than a decade to address the environmental problems of Mexico City. Other groups have been doing similar work on the U.S.-Mexico border. Some Mexican unions have advocated a social agenda. Human rights groups and the two opposition political parties, the National Action Party (PAN) and the Party of the Democratic Revolution (PRD), have been

Robert A. Pastor is professor of political science at Emory University and fellow at Emory's Carter Center. He is the author of Whirlpool: U.S. Foreign Policy toward Latin America and the Caribbean (Princeton, 1992). This article is adapted from a chapter in North American Free Trade, edited by Nora Lustig, Barry P. Bosworth, and Robert Z. Lawrence (Brookings, 1992).



working on the political agenda. President Salinas, eager to gain approval of NAFTA, has been partly responsive to some of these concerns. The election of Bill Clinton as president guarantees that the wider social and environmental agenda will be subject to trilateral negotiations.

A Threat to the Environment?

Environmental problems on the border have been exacerbated by a decade of explosive economic growth in the *maquiladora* industry. By the end of the 1980s, more than half a million workers in 2,000 plants were receiving American-made parts, assembling them, and shipping them back across the border. The rapid expansion of the *maquiladoras* overtaxed a thin infrastructure and generated numerous health hazards stemming from improper or inadequate waste treatment or air or water pollution. At Nuevo Laredo-Laredo, 25 million gallons of raw sewage flow into the Rio Grande every day.

Opponents of NAFTA point to the border to illustrate their fears of what a treaty might mean. Lax Mexican environmental standards, they say, will encourage U.S. companies to move to Mexico. In response, U.S. communities will have to lower their own standards to keep plants at home. The result will be that both countries will be worse off environmentally.

Anecdotal stories of U.S. companies moving to Mexico to escape tough pollution laws abound, but studies of the decisionmaking process of U.S. corporations that invest abroad indicate that environmental considerations have been negligible or nonexistent. A study by Gene Grossman and Alan Krueger found that the costs of complying with environmental laws are small compared with all other costs involved in a decision to move to Mexico. Mexico's comparative advantage is low wages, not lax environmental regulations.

What effect would NAFTA actually have on the environment? As far as the problems on the border, it is likely that a NAFTA treaty would improve, not worsen them. *Maquiladoras* exist because they have been given a partial exemption from tariffs. If tariffs were eliminated, the assembly plants would become obsolete. And a NAFTA treaty would increase the attractiveness of investing inland in Mexico, where wages are lower, labor turnover is lower (*maquiladora* workers often work briefly in the assembly plants on their way across the border), and the environmental and infrastructure problems are far less severe.

On the Move

Environmental regulation and enforcement in Mexico have been changing rapidly in the past four years. In 1988, the Mexican government passed the General Law for Ecological Equilibrium and Environmental Protection, Mexico's first environmental law. Modeled on the U.S. Environmental Protection Act of 1970, it prohibits air, water, and soil pollution and contamination by hazardous waste, pesticides, and toxic substances.

The new law was not seriously enforced until Salinas was inaugurated in 1988, but enforcement has been vigorous, particularly in Mexico City and on the border, since NAFTA talks began. The government has closed 980 industrial sites, 82 of them permanently. Most spectacular was the decision by Salinas to close the oil refinery on the outskirts of Mexico City, at a cost of \$500 million and 5,000 jobs. Within Mexico City the government has gradually replaced old buses, prohibited private cars from driving in the city one day

The NAFTA negotiations
injected life into Mexico's
inchoate environmental strategy.
Provided that the integrated plan
is implemented seriously and
effectively, NAFTA might prove
to be a boon for environmental
concerns in both countries.

a week, and required cleaner-burning gasoline. Salinas personally promised that he would not allow new investment that did not meet stringent requirements. Mexico, he promised, would not try to attract polluting investments.

On February 12, 1992, the U.S. and Mexican governments presented a three-year integrated plan for improving the environment on the border. President Bush pledged nearly \$250 million in fiscal year 1993 to build three waste-water treatment projects and to fund other projects on the border. Mexico also promised \$640 million over the three years of the plan and to work closely with the U.S. Environmental Protection Agency to train more border environmental inspectors and to develop data bases that could be used by both sides.

In short, the NAFTA negotiations injected life into Mexico's inchoate environmental strategy. Provided that the integrated plan is implemented seriously and effectively, NAFTA might prove to be a boon for environmental concerns in both countries. The decision by Mexico to postpone building a large dam in the south because of its implications for the rainforest is also a positive sign. But continuous monitoring will be crucial. As Betty Ferber de Aridjis, spokeswoman for the Group of 100, noted, "Plant closings tapered down dramatically" after the U.S. Congress authorized the president to negotiate the treaty. Nonetheless, when one compares the progress that Mexico has made in the four years since enactment of its law with what the United States has accomplished since passage of its 1970 legislation, it is hard not to conclude that NAFTA has already had a profound and positive effect on the environment in Mexico.

The Social Agenda

Like the environmental issues, the principal problems on the social agenda stem not from a difference in policy but a gap in capabilities (political will, resources, personnel) to enforce the laws. The three sets of issues on the social agenda are labor standards, occupational safety and health, and food health and safety standards.

The U.S. and Mexican labor movements have had close relations over many years, but they disagree about whether NAFTA should be approved: U.S. labor opposes it, and Mexican labor favors it. The reason they disagree is that both believe that U.S. labor will lose jobs to Mexico.

The PRI-dominated Mexican state has a close relationship with the enormous Confederation of Mexican Workers (CTM), whose membership (about 5 million) includes 90 percent of all industrial workers. In terms of labor standards, the relationship has produced a very comprehensive set of legal protections for workers. Indeed, Mexico's social legislation has more in common with Europe's than with that of the United States. The labor laws contain elaborate guidelines on collective bargaining, the right to strike, rights regarding dismissal, an eight-hour day, housing benefits, vacations, profit-sharing, minimum wage, social security benefits, maternity leave, child care, and health services. U.S. workers, in fact, could benefit from some of Mexico's labor standards.

The problems stem from the facts that Mexico's minimum wage is roughly one-tenth that of the United States and that Mexico's labor laws are rarely enforced. Moreover, the standards have no effect on the army of unemployed (about 20 percent of the work force), underemployed (25–40 percent), and the large informal sector.

To help allay the concerns of U.S. workers, President Bush instructed U.S. Secretary of Labor Lynn Martin to sign an agreement with her Mexican counterpart to provide for joint action on the labor-related issues. The memorandum promises to promote “higher living standards, and a safe and healthy workplace with adequate social security, medical and financial benefits.” How this would be done is not clear, however, and U.S. labor unions are skeptical.

Health and Safety

The same pattern applies to occupational safety and health issues, another area that President Bush pledged to improve. Ironically, on this issue as well as on labor standards, the conditions are probably better in the *maquiladora* industry and generally in U.S. corporations in Mexico than in most Mexican firms. On the other hand, some *maquiladoras*, particularly electronic assembly plants, have been negligent in protecting their workers or the surrounding population from toxic materials in the production process.

One of the obstacles to protecting the safety of the workplace in Mexico is the lack of good data on the number or prevalence of work-related injuries or deaths. But the International Labour Office, which acknowledges the unreliability of much of the Mexican data, has estimated that Mexican workers have a fatality rate of 0.12 per million worker hours—roughly four times the rate for U.S. workers.

Regarding food health and safety standards, the United States and Mexico are concerned about the problem of trade in contaminated foods and both have signed a standards code that obliges them to harmonize and make public their scientific certification procedures. *Applying* equivalent standards and regulations, however, is another matter. The United States, Canada, and Mexico will have serious problems in finding common standards and procedures for each particular case, harmonizing the accreditation standards, and enforcing these provisions in a nondiscriminatory way.

Liberal groups in the three countries, fearing that integration based on existing disparities between the United States and Mexico will have a downward effect on standards, wages, and working conditions in all three countries unless specific thresholds are legislated, have proposed a “social charter” similar to the European Community’s Charter of Fundamental Social Rights for Workers. The EC charter lists numerous goals, including collective bargaining, equal treatment for men and women, health and safety, and protection of children, the elderly, and the disabled, all of which would be compatible with laws or norms in all three North American countries.

A study of the relationship between trade and labor standards worldwide suggests that increased trade *can* improve labor standards, but not immediately. And

whether standards improve at all depends on the political framework in the particular country and the governing philosophy of its leaders. Conservatives tend to believe the best way to improve labor standards in the long run is not to interfere with the market in the short run by legislating higher wages or working conditions. Liberals believe the best way to sustain development is to increase aggregate demand by legislating an improvement in wages and working conditions. In fact, both arguments might be true: low wages and bad working conditions are apparently necessary to attract investment and promote early growth, but unless wages improve after a certain period, further development is inhibited.

The concept of linking social improvements abroad with U.S. trade is not new. The U.S. Congress had already conditioned trade benefits and investment guarantees on whether a foreign government provides basic rights to its workers. The Omnibus Trade and Competitiveness Act of 1988, to take a prominent example, makes violation of labor rights an “unfair trade practice.” The particular rights identified in that law are guaranteed by both the Mexican and Canadian governments. In a comprehensive address on NAFTA on October 4, Bill Clinton announced his support of the agreement, but insisted that he would modify the implementing legislation and negotiate supplemental agreements with Mexico and Canada on workers’ rights, health standards, and environmental protection.

Toward Greater Democracy

Although Mexico’s sensitivity to U.S. interference in its internal political affairs is acute, the issues of Mexico’s democracy and its human rights record are unavoidable in a debate on NAFTA. Senator Daniel Patrick Moynihan expressed strong reservations about negotiating “the first free trade agreement . . . with a country that isn’t free.” In Mexico, Hector Aguilar Camín, the editor of an influential journal and probably the intellectual who is closest to President Salinas, has noted that the “institutional logic” of opening Mexico’s economy and linking it with the United States is that ultimately it demands opening “the political marketplace as well.” “Sooner rather than later, I hope,” he concludes, “our tolerance for illegality will shrink, and I also hope we will learn that it is better for us to correct our mistakes ourselves [than to] be forced to correct them by pressures from outside.”

President Salinas has emphasized that NAFTA is an economic agreement and that his government will never permit the United States to impose political conditions or to interfere in Mexico’s internal affairs. Mexico’s political sovereignty, Salinas insists, “is not subject to external evaluation.” Cuauhtémoc Cárdenas, the leader of the PRD, asserts a more historic, defensive nationalism, although he has been encouraging American leaders, albeit indirectly, to use their leverage to compel Salinas to open up the political system in Mexico and invite international groups to observe Mexican elections. In return, Salinas has denounced the Cardenistas as “those who seek to trample on national sovereignty.”

This attempt to stifle debate is inconsistent with Salinas’s own promises of greater democracy. It also be-

trays his contribution to the redefinition of sovereignty. "Historically, nationalism has been the answer to any external challenge," Salinas has said. "Now the big challenge is not being left out of the great integrationist efforts and the great exchange of resources."

Salinas won the presidency in an election widely viewed as rife with fraud. Since then, however, the political system has become increasingly transparent. Though his electoral record has not attained international democratic standards, it is an improvement over those of his predecessors. In July 1989, for the first time in decades, an opposition party won a state governorship, but electoral irregularities impugned the results in other states. The government's electoral record from that point through the midterm elections of August 1991 was uneven. The opposition parties won some local elections but charged that others were stolen, and some evidence supported that charge. Salinas negotiated an electoral reform law with the conservative PAN, but Cardenas's PRD supporters and some PANistas opposed it because the government retained control of the new federal electoral institute.

By mid-1991, Salinas and the PRI had regained substantial popular support because of the economic recovery and because of a program aimed at helping poor communities. The PRI won an overwhelming victory in the August midterm elections, leaving the opposition demoralized. Again, there were charges of fraud—exaggerated, but not without foundation. By permitting exit polls and replacing three PRI governors who were accused of election irregularities, Salinas sent a signal to the PRI cadre that such "alchemy" was no longer acceptable. But he also let them know that the "system" was still being managed.

There are two significant problems in Mexico's politics. First is a lack of confidence in the political system. Before the election in 1991, only 42 percent of the Mexican people believed their vote would be respected—though that figure was up from 23 percent only three years before. Second, as Hector Aguilar noted, the intimacy between the ruling party and the state contributes to the unequal position of those competing against the state.

Salinas has been candid in explaining his efforts to manage the political process gradually to assure a stable political transition and continued PRI dominance. "Electoral democracy is not attained through practices that endanger the nation's stability or the continuity of our institutions." He believes that economic reforms must be fully implemented before full political liberalization can occur. But his approach leaves the political system in an awkward and unstable transition.

Human Rights in Transition

The same can be said of the human rights conditions in Mexico and Salinas's response to them. In June 1990 Americas Watch issued a scathing report on human rights abuses in Mexico, criticizing Mexico's government for torture, disappearances, extrajudicial killings by police and security forces, abuses in the criminal justice system, electoral fraud, rural repression, media censorship, and violence against unions. Stung by the Americas Watch report and charges by

other human rights groups, Salinas established a National Human Rights Commission, under the chairmanship of Supreme Court Justice Jorge Carpizo, and with an advisory council of credible, independent leaders, including Carlos Fuentes and Carlos Payan, editor of the independent *La Jornada*.

Carpizo acknowledges that the federal and local police are the principal sources of human rights violations, a view the public shares. He structured the commission to act as an "ombudsman" in investigating human rights violations and to use publicity to embarrass senior officials in the attorney general's office or in local police stations to remove and, when possible, try human rights violators. Most impressive, Carpizo and the commission's executive secretary, Rosario Green, visited several U.S. cities to explain the purposes and plans of the commission. Such a visit by a senior group of Mexicans to discuss human rights violations in Mexico would have been unthinkable just two years earlier.

Salinas's predecessors did not control the police, a fact they were unwilling to acknowledge for fear that the power of the presidency might appear diminished if people knew the truth. Yet Salinas created in the commission an institution whose work begins from the dual premises that the police are the most serious human rights problem and that the president does not control them—both candid admissions.

Many human rights groups in Mexico, once severely critical of the government, now recognize the credibility of the National Human Rights Commission. Carpizo's own integrity and boldness are, to a great degree, responsible. When he embarrassed the attorney general by disclosing that conversations in the commission were being bugged, the attorney general was replaced. Carpizo also confronted a number of high-profile cases against government officials, and Salinas supported him at crucial moments. The problem of government officials or police acting with impunity has not been erased in Mexico, but important steps in the right direction have been taken.

Mexico also has legitimate concerns about human rights in the United States, particularly the treatment of undocumented Mexican workers. In another scathing report, Americas Watch denounced U.S. border patrols for routine "beatings, rough physical treatment, and racially motivated verbal abuse." Moreover, the report found that U.S. investigations of these charges have been "perfunctory, and the offending agents escape punishment." A second concern that President Salinas has raised is the use of the death penalty—prohibited in Mexico and most other countries—against Mexican citizens by U.S. authorities.

The most egregious political action by the United States was the kidnapping, in Mexico, by the U.S. Drug Enforcement Agency, of a Mexican national, Dr. Alvarez Machain, to bring him to trial in the United States for complicity in the murder of a DEA agent. The U.S. Justice Department asserted a right to kidnap, and it pursued the case despite decisions by two U.S. courts that the kidnapping violated an extradition treaty with Mexico. On June 15, the U.S. Supreme Court ruled in favor of the Justice Department, and Mexicans were enraged. If the United States wants

Mexico to consider U.S. concerns seriously, it will have to find a different way of responding to Mexico's legitimate concerns.

Connecting the Debates

NAFTA is quite different from previous bilateral negotiations between the United States and Mexico in both the nature of the issues and the negotiating process. Traditional diplomatic issues, like conflicts in Central America, have involved the U.S. and Mexican foreign ministries but few other agencies. The NAFTA negotiations cover domestic and international policies and many domestic agencies and groups. Traditionally, dealings between the two countries have involved stiff-arming each other and transforming minor concerns into crises of sovereignty. Today, not only are the issues debated openly in both countries, but groups within each country have built transnational coalitions with counterparts in the other two North American countries to stimulate governmental attention and substantive progress on areas of mutual concern.

Although the agenda—particularly the nontrade issues—appears to be only a list of U.S. concerns, many groups in both countries share the same goals on the environment, labor standards, and democracy. Indeed, it might be more accurate to say that groups in Mexico are using the U.S. debate to enhance their bargaining leverage within Mexico than to say that the United States is using NAFTA to press its agenda on a passive Mexico.

The Beginning, Not the End

In a free trade area, any domestic policy that confers a discriminatory advantage on a country's exports or a disadvantage on imports is legitimately a trade issue, and any selective incentive for investment or relocation is an investment issue. Moreover, if a country's laws require that imported goods be produced according to certain safety, labor, or environmental standards, then a nontrade item can become a trade issue. Once tariffs and quotas are eliminated, trade-related "distortions" that become eligible for negotiation include a wide swath of policies, such as sales taxes, safety or environmental laws, subsidized oil or gas prices, tax inducements, and access to timber on government lands at below-market prices. Labor rights or workers' compensation in one country becomes an issue in the other. As integration proceeds, the line that separates internal and external issues blurs.

Thinking of the integration process between Mexico and the United States in this way makes it possible to see NAFTA as a potential device for smoothing the differences in policies to permit economic integration between the two countries to continue expanding.

If Congress accepts NAFTA, it will mean not the end of negotiations among Canada, Mexico, and the United States, but the beginning of a continuing process of negotiating issues that had been previously regarded as domestic. Salinas's decision to break with the past and to contribute actively to dismantling trade and investment barriers within the Western hemisphere is a hopeful early sign of an emerging North American and eventually hemispheric community. ■

If Congress accepts NAFTA,
it will mean not the end of
negotiations among Canada,
Mexico, and the United States,
but the beginning of a
continuing process of negotiating
issues that had been previously
regarded as domestic.

Tough and Smart on China

BY HARRY HARDING



When Bill Clinton moves into the Oval Office, he will face a potential confrontation with China that could disrupt his focus on domestic affairs.

For 18 months after the Tiananmen crisis of 1989, the Bush administration undertook a seriously flawed policy toward China. It muted its rhetoric, resisted congressional penalties against Peking, and sent senior officials to China despite a ban on high-level contacts. Moreover, it unilaterally relaxed several of its own sanctions, in the vain hope that Peking would reciprocate.

Then, under pressure from Congress, Bush switched from carrots to sticks. He used the threat of higher tariffs and stricter export controls to persuade China to alter its arms sales and foreign trade practices. He also endorsed Taiwan's membership in GATT and approved the sale of 150 F-16s to the island.

This new policy achieved better results. China agreed to protect foreign intellectual property, end unfair export practices, and provide greater market access to U.S. firms. It also ratified the Nuclear Non-Proliferation Treaty, and agreed to honor the Missile Technology Control Regime. After a false start, American China policy was finally on track.

Still, not fully aware of this change in direction, many in Congress call for a more confrontational stand. They want to make China's most-favored-nation status contingent on improvements in Peking's human rights policies, foreign trade, and arms exports. They also want to establish a new radio service, originally called Radio Free China, to broadcast news and information to the Chinese people. Despite their flaws, Clinton has endorsed both proposals.

As a result, Chinese leaders view Clinton's election with

suspicion. They see that, alone among Western nations, the United States is not only maintaining sanctions against China, but considering modifying China's MFN status. They regard the Radio Free China proposal as a bid to subvert their government and the sale of F-16s as a violation of the 1982 communiqué on arms sales to Taiwan. They are threatening retaliation against any of these moves.

In this context, two developments could push the situation into crisis. Either Peking could retaliate against the F-16 sales to Taiwan, or Clinton could introduce the new China policies he proposed during the campaign. Given the testy mood in each capital, if one side acts provocatively, the other is unlikely to back down.

A crisis between Peking and Washington would not mean military confrontation, but it would be an expensive distraction for the new administration. A trade war would raise prices for U.S. consumers and hand China's growing markets over to America's rivals. A diplomatic contretemps would tempt China to throw out existing Sino-American agreements on trade and proliferation and stop cooperating on other international issues. It would strangle the cultural exchanges that are bringing new ideas into China. Moreover, in a confrontation with China, the United States would not have the support of its Asian allies.

Clinton says he wants to avoid coddling dictators in Peking. But he should be smart as well as tough. Congress will not reconsider China's MFN status until June. Clinton should use that time to forge a strategy based on calculation, not emotion:

■ Clinton should distance the United States from human rights abuses in China and press for the release of specific pris-

oners. He should also establish a new radio service for China, but place it under the respected Voice of America. Above all, he must understand that the systemic changes he wants will ultimately come from domestic forces, which will be fostered more by continued commercial and cultural interaction with the United States than by economic sanctions.

■ Clinton should continue discussions with China over its trade practices, arms sales, and military modernization program, using multilateral forums where appropriate. He must also engage China in areas of potential cooperation, including the disputes in Indochina and the Korean peninsula. He should make clear that the outcome of these negotiations will strongly influence his policy on China's MFN status.

■ If this dialogue shows promise, Clinton should moderate his position on MFN, threatening to withdraw it only if there is significant and sustained retrogression in Peking's human rights policies, foreign trade, or arms sales. He could adopt a similar policy for all other countries whose MFN status is reviewed annually.

The responsibility for avoiding a crisis is not Clinton's alone. Peking, too, must refrain from acting precipitously. It should accept the F-16 sales to Taiwan. It should honor its existing commitments to the United States and negotiate in good faith on remaining issues. It should supplement its economic reforms with political change. And it will have to accept a reasonable linkage of its MFN status to its foreign and domestic policies.

A strategy of reciprocal restraint will not produce a second honeymoon between China and the United States. But it could prevent the confrontation that would be so costly to both. ■

Harry Harding is a senior fellow in the Brookings Foreign Policy Studies program. He is the author of A Fragile Relationship: The United States and China since 1972 (Brookings, 1992).

Free Trade with Mexico?

BY GEORGE L. PERRY



Although the North American Free Trade Agreement was not an issue in the fall elections, it soon promises to become one. Bill Clinton has already endorsed the broad outlines of the agreement, which would phase out virtually all barriers to trade and investment between the United States, Mexico, and Canada. But he has reserved the right to modify it. How he balances particular and general interests will affect many U.S. workers and firms in the years ahead.

Arguments for free trade abound. One, the law of comparative advantage, shows that trading partners both gain when each does what it does relatively best. Comparative advantage is easiest to see when a nation has either an abundance or absence of natural resources. Saudi Arabia exports oil and imports virtually everything else. Japan imports almost all its energy and raw materials and pays for them by exporting manufactured goods.

U.S. comparative advantage and trade patterns reflect not only static traits of the economy, such as our rich farmland, but also our leadership in changing fields that require intensive R&D, technical skills, entrepreneurial talents, and a relatively sophisticated work force. Since World War II, the United States has used free trade to open markets for U.S. products in such fields—in the process adding to the nation's overall prosperity and the income of the average worker.

Arguments for free trade come from the import side too. Over the past decade, for example, foreign competition has spurred productivity and quality in complacent and inefficient U.S. industries such as steel and autos.

What about free trade with Mexico in particular? Again, the arguments are mostly positive. First, trade with Mexico

has been on the upswing, with U.S. exports to Mexico rising more than imports. Some complain that the export growth has been in capital goods that will be used in part to produce goods for export back to us. But that merely reflects the comparative advantage in each country. Second, many new imports from Mexico will compete with products that would otherwise come from other low-cost producers, especially those in the Pacific Rim, not with U.S. goods. So U.S. job losses will be far fewer than one might expect. Third, with the U.S.-Mexican border as open as it is to immigration, expanding the base of good jobs in Mexico will to a degree replace job competition from Mexican immigrants with job competition from Mexican imports.

However, there is also a serious argument against open competition from a low-wage country like Mexico: the uneven distribution of costs and benefits as new imports displace some domestic production. It is hard to factor these distributional issues into an economic analysis of policy change, to balance gains or losses to individuals against gains or losses for the average. But that is no reason to ignore them.

Some economists brush problems of job losers under the rug by reasoning that change that helps poor countries like Mexico is justified on egalitarian grounds. But U.S. policy should focus on U.S. workers. And the cost to a worker displaced by the opening up of trade can be devastating. In a company town, the closing of a plant can mean the end of any realistic hope of employment at home. And moving elsewhere often means losing whatever wealth workers have acquired through the equity in their homes. Fortunately, such worst-case scenarios figure to be few. But

even workers who do not have to relocate are likely to suffer unemployment and extended loss of income if they lose their jobs to import competition.

Extreme protectionists stress only such costs and ignore the benefits of trade. But whenever trade barriers are analyzed for individual industries and commodities, it turns out to cost far more to protect a job than the total earnings of the worker whose job is protected.

Short of protection, what can be done? A strong U.S. economic expansion would greatly reduce the costs of job loss stemming from import competition. Greater incentives to domestic business investment would keep some firms here that might otherwise shift production to Mexico. Reducing trade barriers gradually rather than abruptly would make it easier for U.S. firms and workers to adjust without interfering with the longer-run allocation of production dictated by free trade. Finally, generous and well-designed financial, training, and relocation assistance to affected workers is in order.

U.S. policy should also win commensurate reductions in Mexico's barriers to our exports, which are now much steeper than our barriers to theirs. NAFTA should not repeat the big trade policy mistake of the past decade: failing to open Japan sufficiently to U.S. goods and services.

Clinton appears to appreciate both the benefits of open trade and the costs that the transition will impose on specific workers and firms. His political skills will be tested by how successfully he opens foreign markets for U.S. exports and how well he resists the more extreme protectionists while still providing assistance and whatever security is possible to workers who lose out to competition from abroad as trade barriers are reduced. ■

George L. Perry is a senior fellow in the Brookings Economic Studies program. With William C. Brainard, he directs the Brookings Panel on Economic Activity, and edits its journal, the Brookings Papers on Economic Activity.

Continued from page 3

have agreed to have their properties assessed and few public officials who must ultimately either enable or endorse plans to establish business improvement districts believe they are establishing private governments that either replace or challenge the services or authority of local government. Most believe they are improving the capacity of business people, property owners, and taxpayers to govern themselves more effectively, thereby creating both a public benefit (a cleaner, safer, more attractive downtown) and a private benefit (improved property values and greater sales).

Through efforts as varied as "community watch" neighborhood security programs, coalitions of church groups to support housing for the homeless, and BIDs, America is busy remaking its governance patterns and principles in ways that both affirm "public" government and enrich it. In an era when there is no clear dividing line between public and private fields of interest, BIDs are simply one more example of community members coming together to solve problems and improve both individual and collective interest.

*Richard H. Bradley,
International Downtown
Association*

Are Some Neighborhoods More Equal Than Others?

■ Janet Rothenberg Pack ("BIDs, DIDs, SIDs, SADs," fall issue) acknowledges that business improvement districts are not a panacea for urban ills, but concludes that allowing business property owners in small areas within a city to choose to pay additional taxes for additional services is likely to provide a boost for our cities. I tend to agree—but with one strong reservation.

The danger, mentioned by Pack, but not sufficiently emphasized, is that the concept of submunicipal business improvement districts will be extended to residential areas where variation in the wealth of differing neighborhoods is likely to lead to socially unacceptable outcomes. The concept of giving individual residential neighborhoods within a city the authority to levy additional taxes to provide higher-quality services than provided in the rest of the city is abhorrent to me. Although it might yield some efficiency benefits as residents tailor service packages to their preferences, the resulting wealth-related disparities in services such as education and public safety are likely to be unacceptable on distributional grounds.

Helen Ladd, Duke University

The Health Care Cost Trap

■ Joshua Wiener and Raymond Hanley ("Winners and Losers," fall issue) are surely right that any serious effort to control health care costs will likely involve some form of aggregate budget or spending ceiling. Total spending equals the volume of services times price: that is a mathematical tautology. But for some reason, it has become unacceptable in the United States even to think about controlling health care spending by constraining prices—hence, all the emphasis on rationing services.

More than 70 percent of health costs are direct payments for labor. As health care costs have spiraled upward in the past two decades, so have health care incomes—not only for physicians, but for nurses, other workers, and all the consultants, lawyers, and entrepreneurs now employed in the name of cost containment.

The reason European countries don't have to make explicit allocation decisions of the sort

Wiener and Hanley think we will have to make is that they negotiate incomes with physicians and other health care providers. And they do use less technology, because their pricing and payment structures make irrational the kinds of investment decisions that in the United States feed proliferation of high-tech services used at inefficiently low rates.

If a benevolent genie were to reduce all health care prices by 20 percent tomorrow, we wouldn't have to spend so much time talking about rationing. We don't need a benevolent genie. We don't need—or want—formal price controls. All we need is the political will to reshape health care markets to create some price discipline.

*Bruce C. Vladeck,
United Hospital Fund*

The Telecommunications Picture in France

■ The way industrial policy is made in France has a good deal to teach us Americans, as Shlomo Maital ("The Global Telecommunications Picture," summer issue) makes clear. But the lessons he draws from the French experience with Minitel, the small computer terminal distributed to more than 6 million households, are not the right ones.

First, the annual sales revenues for conversation-oriented services should be \$200 million, not \$200 billion.

Second, France Telecom seized on the Nora-Minc report to legitimate its expansion plans rather than being suddenly struck with the idea for telematics. After spending massively on building its phone network, it needed to maintain investment to fuel the domestic telecommunications equipment industry, which it had won control over after a long struggle.

Finally, Maital overstates the

ubiquity of the Minitel terminal and the use of it by the French. It is in only one of five French households, and use is heavily concentrated. Just 3 percent of the Minitels produce a third of traffic volume, and a quarter of the terminals generate 71 percent of usage.

Still, in terms of his conclusions, one can justifiably argue that the "fragmented" American telecommunications industry comes up looking pale and anemic compared with its international competitors. Overseas investment by U.S. telephone companies is a safer bet on something they already know how to do than on risky involvement in new media, which disturbs state-level regulators and may not pay off for a decade or more, if at all.

But let's not fawn over the French. The bill for French telematics has been paid mostly by the business customer. France Telecom engages in all the cross-subsidizations that U.S. policy has been trying to outlaw for more than a decade. They now have a huge investment in the technology of the 1970s.

The path to the multimedia platform of the future in the United States more likely lies in strengthening the government's role in establishing technical standards. We're still the only country with a pluralistic standard-setting process. This is a far more hopeful direction to look to improve U.S. industrial policymaking than reestablishing monopolies or, worse, establishing multi-industry oligopolies in the name of technological development. The "someone" that "has to be the central coordinator" ought to be the only someone that includes all of us.

*David Lytel,
Cornell University*

The Review welcomes comments from its readers. Letters will be edited to conform to style and space.

BROOKINGS BOOKS FOR A NEW ADMINISTRATION

MEMOS TO THE PRESIDENT A Guide through Macroeconomics for the Busy Policymaker

Charles L. Schultze

"Long on examples and explanations, short on arcane economic theories, Schultze's twenty-nine easily digestible memos can provide either a quick brushing-up on the basics or a solid grounding in macroeconomic principles." *National Journal*
cloth \$24.95

SETTING DOMESTIC PRIORITIES What Can Government Do?

Henry J. Aaron & Charles L. Schultze, eds.

"An outstanding resource for policymakers in Washington and around the country. The essays tackle a host of difficult policy issues... [and] offer a hard-headed assessment of what government policies work and do not work, and how we can make government work better and more cost-effectively. I recommend this book to my colleagues in the Congress, to policymakers around the country, and to anybody with an interest in understanding the complex policy issues facing our country today." Rep. Lee H. Hamilton
cloth \$32.95 / paper \$14.95

REVIVING THE AMERICAN DREAM The Economy, the States, and the Federal Government

Alice M. Rivlin

"Presents an urgent, well-argued case for abandoning rigid old ways of looking at public policy issues and government... Readers who think they couldn't possibly get through a book about economic policy because they don't understand numbers do not have to worry. Ms. Rivlin unfailingly explains in nice, straightforward English what the numbers show." *The New York Times Book Review*
cloth \$15.95

ORGANIZING THE PRESIDENCY Second Edition

Stephen Hess

"This book is as close to a primer as this reviewer has read for a long, long time... [It] is skillfully researched, logically constructed, and thoughtfully presented." *National Forum*
cloth \$31.95 / paper \$12.95

At bookstores and from BROOKINGS BOOKS
For credit card orders, call toll-free 1-800-275-1447
or (202) 797-6258 in the Washington area, or fax
(202) 797-6004. Or mail check to: The Brookings
Institution, Dept. 029, Washington, D.C. 20042-0029.



SHOULD WE JUST SAY "NO" TO THE WAR ON DRUGS?

WHERE DO OUR PRIORITIES LIE? What will the legacy of "sound bite" public policy be? This issue of *Dædalus* examines questions raised by the drug policies of the Reagan-Bush years, featuring

**10,000 deaths annually
from illicit drug use**

authors such as Peter Reuter of RAND, Mathea Falco of the Cornell Medical Center, and Ethan Nadelmann of Princeton University.

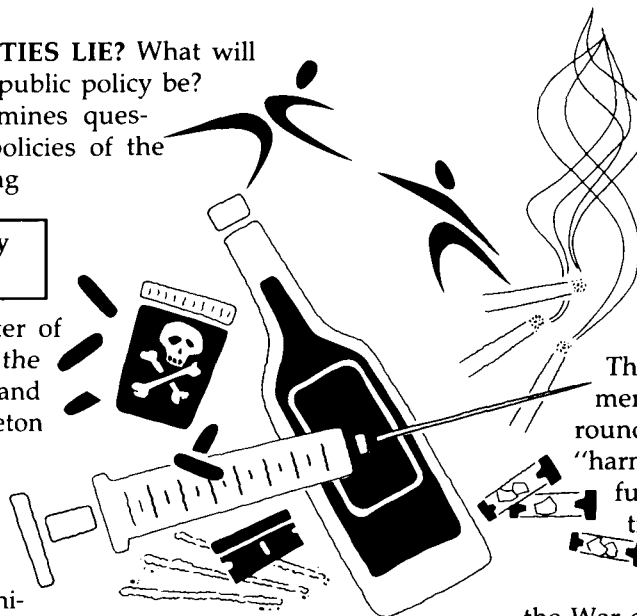
**100,000 deaths annually
from alcoholism**

Mark Kleiman of Harvard University asks: "Why should drunk drivers lose their right to drive but keep their right to drink?"

Can we continue to fight a losing battle, forcing criminal justice solutions on problems that are perhaps more accurately labelled medical or social?

**400,000 deaths annually
from cigarette smoking**

This issue offers insightful commentary into the debates surrounding: personal freedoms, "harm minimization," and the funding and regulation of treatment centers. A primary concern for many is the allocation of funds within the War on Drugs: enforcement, education, or treatment.

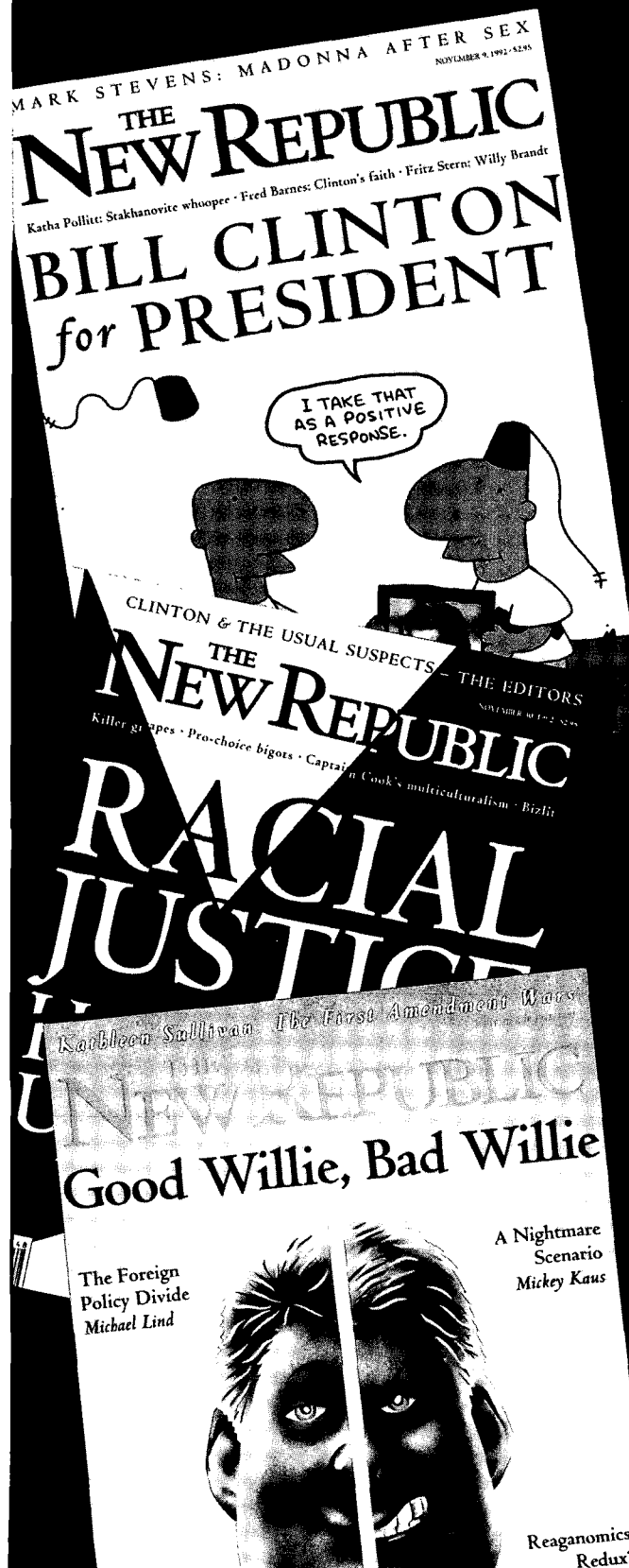


DÆDALUS

Journal of the American Academy of Arts and Sciences

To order: Send \$9.95 (check, money order or Visa/MasterCard) to *Dædalus*, 136 Irving Street, Suite 101, Cambridge, MA 02138

"Mandatory Reading"



Why did *The Economist* say *The New Republic* was "mandatory reading?"

Because the weekly debate that goes into forming *The New Republic* mirrors the cut and thrust of the national debate on every important issue. Our views are eagerly sought out. Bill Clinton reads it. Al Gore writes for it.

Subscribe now and you'll get the whole story. *The New Republic* publishes the most penetrating reviews of movies, the theater, and the arts you'll read anywhere. And book reviews? Well, why don't you find out for yourself. Return the coupon now or call 1-800-827-1289.

Name (please print) _____

Street _____

City, State, Zip _____

Yes, send me 48 issues for just \$44.95

- ☐ Payment enclosed ☐ Bill me
☐ Please charge my:
☐ Visa ☐ MC ☐ AmEx

Account # _____

Expiration date _____

Signature _____

Return this coupon with payment to:

The New Republic
P.O. Box 602
Mt. Morris, Il
61054

Allow 3-5 weeks for your first issue. Offer good for U.S. addresses and new subscribers only. Foreign please add \$30 for surface mail.

5BUS3